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ALTERNATIVE INVESTMENTS IN PRIVATE MARKETS:

THE ROLE OF FINANCIAL INTERMEDIARIES

– THE CASE OF THE AZIMUT GROUP–

Relatrice: Chiar.ma
Prof.ssa Caterina Lucarelli

Tesi di Laurea di:
Francesco Tiranti

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Introduction

This dissertation reflects on alternative investments in private markets. The final goal is to analyze private assets' performance in order to state whether private capitals could be considered as a valid investment option.

Starting from the fundamentals of the financial system, this study deepens the figure of financial intermediaries. It is stressed their importance in guiding investors within this complicated world where lack of information and low level of transparency are just some of the several difficulties that may be encountered in private markets investments. Therefore, the centrality financial intermediaries cover represents the basepoint of the discussion.

The focus moves then towards the pure analysis of alternative investments. Specifically, the attention converges into the private market ecosystem, which is described in its totality through statistics: both benefits and challenges connected to it are discussed in order to give a complete sight over the matter. Besides, the analysis goes into details of the main private markets investing instruments, such as private equity, private debt and private real assets, by providing data, strategies, associated risks and expected returns.

The last chapter is left to the case study of the Azimut group, an Italian asset management society. It will be interesting to note the Azimut group evolution in the asset allocation and in the implementation of new alternative financial products.

The analysis initially sheds light over its history, its method and its purpose in order to give a global overview of the society. Later, the focus moves on to the path undertaken towards private markets. In particular, it is made an evaluation of the controlled private equity fund “Azimut Demos 1” and the total asset breakdown to point out the extent to which the Azimut group believes in alternatives.

All in all, the attempt is to clarify the performances linked to the associated risks of running private markets investments. This dissertation is, indeed, trying to discuss the real potential hidden behind this kind of alternative investment. A potential that would be fully exploited only if financial intermediaries, as in the case of the Azimut group, work properly to introduce investors to private markets and to implement offers able to satisfy alternative financial profiles.

Chapter 1 – Evolution of the financial intermediation

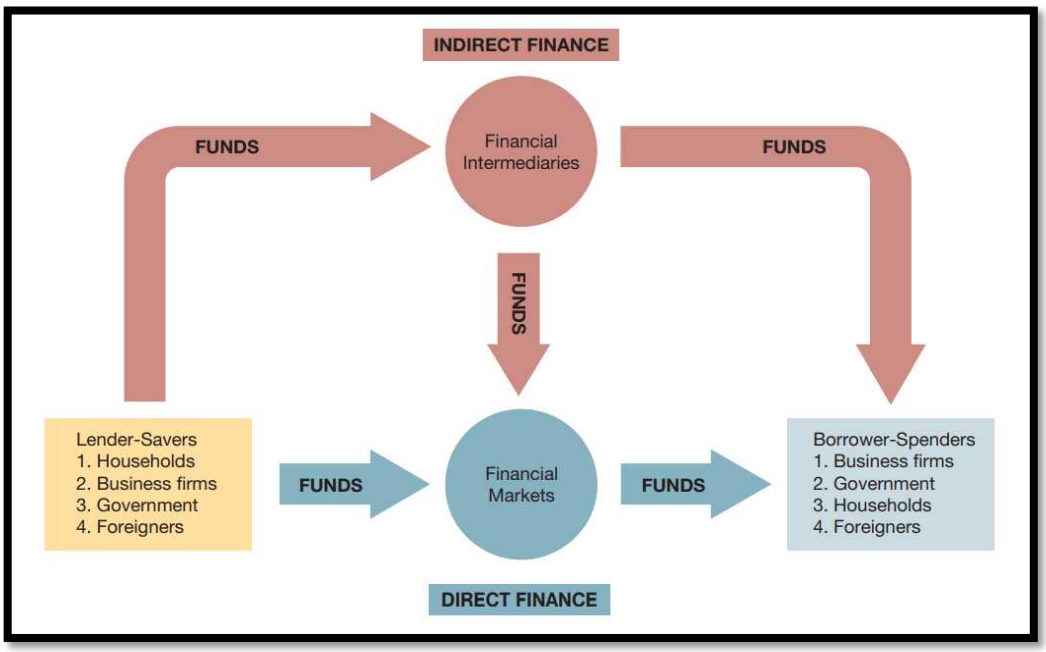
This first chapter presents an overview of the financial system and its components. In particular, the discussion covers the analysis of financial intermediaries, illustrating their role, their functions, and their relationship with investors.

1.1 Basics of the financial system

Financial markets serve the fundamental function of moving money from those actors who have a surplus of funds to those ones who have a deficit of funds. As visible from *Figure 1* below, the principal subjects involved in this money flows are households, firms, governments and foreigners.

On the left side, stands the category of lenders (or savers), the ones with a surplus of funds, while, on the right side, there are borrowers (or spenders), the ones with a deficit of funds. Funds can move both directly and indirectly with the scope of transferring money from one part to the other. The direct channel connects lenders straight to borrowers. Instead, the indirect channel presupposes the presence of a third part, which is represented by financial intermediaries. In the former case, it is possible to speak about direct finance, while, in the latter case, about indirect finance.

Figure 1: Structure of the financial system



Source: Frederic S. Mishkin, "The economics of money, banking and financial markets", thirteenth edition, 2021.

Financial markets, financial actors and financial intermediaries constitute a whole that is the financial system. The more advanced economies strive for creating stable and efficient financial systems that aim to reach economic wealth, which is the final goal of each developed economy[1].

[1] Cf. Frederic S. Mishkin, "The economics of money, banking, and financial markets", thirteenth edition, 2021.

1.2 The relevance of financial intermediaries

Financial intermediaries cover several fundamental roles. Throughout this paragraph, each single function they perform is described in order to stress how important they are for the proper functioning of the economy.

As previously shown in *Figure 1*, funds can move indirectly from lenders to borrowers involving a third part to assist the transaction. Indeed, financial intermediaries stand between the two parts and facilitate the transfer of funds. In order to do that, they "simply" borrow money from savers and offer loans to spenders. This mechanism works because savers, which have a surplus of funds, are interested in investing, while spenders, which have a deficit of funds, need to finance their projects.

1.2.1 Asymmetric information

To introduce the topic of asymmetric information, a special mention needs to be done with regard to George Akerlof, Michael Spence, and Joseph Stiglitz, who developed the theory of asymmetric information in the 1970s and 1980s. Their contribution was so important that they received and shared the Nobel Prize in economics in 2001.

Information is a crucial aspect to be considered when investing in financial markets. In financial transactions, one side, usually the category of lenders, does not possess a sufficient mole of information about the other side, making the

decision-making process inaccurate and inefficient. According to Rothschild and Stiglitz, "*even a small amount of imperfect information could have a significant effect on competitive markets*"[2]. This last concept is even more emphasized with regards to non-quoted markets (discussed in chapter 2, paragraph 2.1.), where data and reports are scarce and present a very low quality of details. Indeed, it may reveal tough for individual investors – acting through direct finance – to find out specific information concerning the companies they want to invest into. To sum up this concept in just one line, it is possible to state that the situation in which "*the sellers have more knowledge about the quality of a car than the buyers*"[3] can be defined a problem of asymmetric information.

The presence of asymmetric information results in two type of problems that are adverse selection and moral hazard. The principal difference between them resides in the fact that the former is a problem of asymmetric information which occurs *ex-ante* the transaction, while the latter is a problem of asymmetric information which occurs *ex-post*.

1.2.1.1 Adverse selection

Akerlof analyzed the problems related to asymmetric information giving emphasis to the issue of adverse selection. In his famous article, renowned as

[2] Rothschild M. and J. E. Stiglitz, "Equilibrium in Competitive Insurance Markets: An Essay on the Economics of Imperfect Information", Quarterly Journal of Economics, 1976, pp. 648.
[3] Akerlof G. A., "The Market for 'Lemons': Quality, Uncertainty and the Market Mechanism", Quarterly Journal of Economics, 1970, pp. 489.

“lemons problem”, Akerlof provided the example of used cars market where he equaled bad cars to “lemons”. Akerlof stated that potential used cars buyers are usually unable to verify the status of the cars they are going to buy. In this sense, a buyer cannot be totally sure if a certain used car will work (a good car is considered a peach) or will cause troubles (lemon). On the contrary, the used car owner is more likely to have accurate information about the status of his own car. Since the cost of used cars takes into account the average quality of the cars available in the market, a “lemon” car owner is very stimulated to sell because the value of his car is less than the price a buyer is going to pay. Obviously, the opposite is true for what concern a “peach” car owner. As a consequence, many “lemons” and just few “peaches” will be entering the market, leading to a general lowering in terms of quality. Correspondingly, the number of car sales will fall, given that no one want to buy a “lemon”. On the whole, the used cars market will sell less cars, therefore it will no longer be efficient[4].

The example above clearly explains how serious adverse selection problems are and how it is difficult to deal with them. But how is it possible to reduce this kind of asymmetric information? What kind of solution have to be implemented? There are three principal ways to contrast adverse selection: one regards the

[4] Cf. Akerlof G. A., “The Market for ‘Lemons’: Quality, Uncertainty and the Market Mechanism”, Quarterly Journal of Economics, 1970, pp. 489 – 500.

government's intervention; another regards the private production and sale of information; a further one regards the mediation of financial intermediaries.

The first possible solution to reduce asymmetric information linked to adverse selection comes from the intervention of the institutions, in particular the government. To help savers discerning good firms and bad firms, government may give incentives to those firms that spontaneously share their information to the public. In such a way, investors are more likely to invest in good firms rather than in bad firms, since good firms are encouraged to release their data while bad firms are not. According to Spence, "*if the incentives for veracity in reporting anything by means of a conventional signaling code are weak, then one must look for other means by which information transfers take place.*"[5], so that it is crucial to give generous incentives to open and transparent firms. Nonetheless, this case presents a fault. On the one hand, it is true that government's intervention lowers the adverse selection problem, but, on the other hand, it is also true that firms still have much more information than savers. The quality and the good status of a firm go far behind data and numbers written on balance sheets and sales reports. Sometimes bad firms are able to hide their bad status, showing themselves in good health in order to increase their perceived value. Moreover, the practice of providing

[5] Spence, A. M., "Job Market Signaling", Quarterly Journal of Economics, 1973, pp. 356.

misleading information may increase the probability that savers invest in bad firms, given that they may be not capable of reading between the lines.

A second solution to adverse selection is represented by the private production and sale of information. When lenders are not capable of discerning good firms, with a low risk and a high return profile, and bad firms, with a high risk and a low return profile, they often lean on private companies that collect information on their behalf. Famous and well-known companies in this field are, for example, Standard & Poor's and Moody's. They carry on investigations about firms' balance sheets, assets management, investment activities and other financial elements that may affect investors' choices. Savers usually have no time and lack of expertise to gather such kind of information. Since those data are key, investors are willing to pay in order to get it. According to Rothschild and Stiglitz, "*many of the peculiar institutions of these labor markets arise as responses to the difficulties that they, or any competitive market, have in handling problems of information*"[6]. Although this system of private gathering and sale of information is well organized, it presents an issue. The adverse selection cannot be totally solved because of the existence of free riders. These are people who take advantage of the information gathered by others without paying for them. Let's think about a lender who is willing to invest his savings. Now, let's imagine that he decides to first buy financial

[6] Rothschild M. and J. E. Stiglitz, "Equilibrium in Competitive Insurance Markets: An Essay on the Economics of Imperfect Information", Quarterly Journal of Economics, 1976, pp. 648.

information, so that he is able to invest in a good firm that may be undervalued. Here comes the free rider, who copies the lender's financial movements without paying for the information. Then, another free rider does the same and a further one after him. This circumstance creates of a waterfall mechanism, where many people behave as free riders. Now, given that the lender earns less than free riders because of the information cost, he will be no longer incentivized to purchase information at first.

The example above showed how serious the problem of free riding is and how the market of information is able to collapse. If buying information at first would facilitate others, no one will do it anymore. Therefore, the less the demand of information the less the number of information produced and, consequently, due to a scarce flow of information, the higher the number of problems related to asymmetric information.

The previous argumentation highlighted and discussed two possible solutions to adverse selection. It comes out that government's intervention and the private production and sale of information are just partial solutions to the problem, in fact they both have faults in their strategy. Even with correct tools and a good quality of information, investing directly into financial markets may be tough for lenders. This is the reason why financial intermediaries are so essential and why indirect finance is even more important than direct finance. Indeed, financial intermediaries serve the fundamental roles of giving lenders the information they

require to invest mindfully and maintaining financial transactions confidential in order to avoid free riding. Let's imagine an investor who rely on a mediator to carry out his investments. When a client knocks at the door, it has already analyzed the market and it is able to address him to selected good firms, which perfectly fit with his financial profile. Furthermore, by making confidential transactions rather the mediator impedes free riders from following lender's financial movements. This example clearly explains how financial intermediaries are able to reduce the adverse selection issue.

The relevance of financial intermediaries depends also on the context. It is different to operate in developed economies, where information is easy to get and has a satisfactory level of quality, rather than developing economies, where information is hard to obtain and lack of quality. The harder the way to get quality information the greater the role of financial intermediaries. For instance, in the case of the Italian financial market, information is quite easy to get, being Italy an advanced economy and being involved in a transparent international context like the European Union. As a consequence, the role of financial intermediaries should decline as information become more and more accessible to the public and that's what happened in the last few decades. As financial markets become larger and more transparent and as information technology made great strides, the importance of financial intermediaries have significantly decreased in many advanced economies. Nevertheless, this dissertation focuses on the one hand, on the role of

financial intermediaries, on the other hand, on investments in alternative assets like private equity or private debt. For this reason, the role of financial intermediaries is still fundamental because of the obstacles in approaching non-quoted markets and non-listed companies that usually provide a scarce and a low-quality mole of information. Hence, this thesis examines the circumstance in which financial intermediaries' task is to diminish asymmetric information within a non-regulated financial market.

1.2.1.2 Moral hazard

So far, the analysis covered problems and remedies to different adverse selection circumstances. Now, the focus moves over to the analysis of asymmetric information circumstances that occur after the financial transaction takes place. Moral hazard occurs when borrowers have incentives to pursue their own interests rather than lenders' ones. In doing that, borrowers usually conceal crucial information to lenders. It is possible to distinguish two major cases of moral hazard problems, whether it is about an equity contract or a debt contract.

In equity contracts, the issue of moral hazard is likely to arise, for example, when managers of a certain firm, who own just a small part of it, behave not following stockholders' interests, who, instead, own the largest part. In case like that arises the so called 'principal-agent problem'[7]: the stockholders, who possess

[7] Cf. Mirrlees J. A., ''The Optimal Structure of Incentives and Authority within an Organization'' Bell Journal of Economic, 1976, pp. 105 – 131.

the great majority of stocks, are called principals, instead the managers, who act in stockholders' behalf, are called agents. Since managers have control over the firm, they may pursue actions in order to maximize their profit rather than increase firm's value. That may be the case of a company which reports financial losses at the end of the year because managers have raised their salaries or have carried on a lazy administration, not asking too much from them and their employees in terms of working effort and self-denial. Such kind of situations happen because one part (the manager in this case) has more information than the other part (stakeholders) regarding the actions and the activities that are going on within the company's administration.

In debt contracts, moral hazard concerns situations in which borrowers receive funds from lenders who expect to get back the fixed amount they provided plus an interest over that amount. The problems arise when borrowers decide to run investments that are riskier than what expected. Let's think about an investor who want to sign a debt contract with an entrepreneur who is going to start a business in healthcare. The investor may assume that investing in such kind of business is safety, though, once the entrepreneur has obtained funds, he decides to spend everything to experiment an innovative medical treatment to heal from cancer. In

this case, moral hazard comes when borrowers exploit ex-post the funds they get from lenders, who are unable to contrast borrowers' actions[8].

To solve moral hazard troubles, it is possible to implement several solutions. One regards the monitoring activity, another concern restrictions within covenants, a further one is represented by the intervention of the government and one last is constituted by the exploitation of the indirect channel through financial intermediation.

Monitoring is the activity that entails a systematic observation over the investments made. It is a way to produce information that, for example, shareholders implement to check out if the management of a certain company they have invested into is doing things right or not. However, this process may be very expensive, especially if undertaken privately. In fact, time and money used to carry on such kind of investigations are so much that some economists wrote about costly state verification, stating how difficult is to pursue the monitoring activity in some circumstances[9]. Within the moral hazard issue, the free riding problem still represents a form of market inefficiency, given that some shareholders may not be interested in spending their time and money to monitor a company while other shareholders are. The result, as in the adverse selection case, would be the

[8] Cf. Robert R. Bliss and Stephen D. Cauley, "Moral Hazard and the Structure of Debt Contracts", 2007.
[9] Cf. Robert M. Townsend, "Optimal Contracts and Competitive Markets with Costly State Verification", 1979, pp. 265 – 293.

possibility that no one will invest in the monitoring activity in the future, ending up with an asymmetry of information.

The second solution to moral hazard problems is the prevention through the signing of contracts packed with constraints that are able to impede or, at least, to discourage malicious behavior at the hands of the borrower. Those contracts are complex legal documents due to the fact that their function is to avoid unpleasant misconducts that may be detrimental for the lender. For instance, some restrictions are directed to rule the way of spending money: in order to keep the borrower away from pursuing risky investments, it is possible to oblige them to allocate money only in some predetermined activities; other restraints request for a collateral, whereby the lender feels the necessity to preserve his outlay from fraudulent intentions (this is one of the most common forms of protection used in the field of debt contract, considering that the borrower is going to retrieve what he has offered as a guarantee only if certain conditions are met); even further constrains regard the duty of providing lenders a constant and periodic documentation to attest the ongoing performances of the company's activities with the purpose of facilitating the expensive monitoring process (this type of contracts usually annexes the investor's right to scope out the business records at any time).

The third way to deal with moral hazard concern the action of national governments and international entities: those institutional bodies are contrasting asymmetric information through regulations that aim to enhance the level of

transparency, integrity and fair competition in financial markets in order to create robust, reliable and efficient financial systems. To reach this goal, all advanced economies force companies to comply with severe accounting regimes. Indeed, these fiscal systems impose firms to provide accounting registers to give proof of their financial positions, so that to speed up the verification practices carried on by national monitoring institutions. Moreover, very heavy penalties are inflicted to those ones who are guilty of grievous financial crimes like embezzlement or fraudulent bankruptcy.

The last remedy to moral hazard pertains financial intermediation. As mentioned in the adverse selection paragraph, using indirect finance and lean on intermediaries may solve annoying problems like free riding or contract fulfilment. For instance, cunning borrowers may take advantage of flaws within the contracts they signed with lenders. There are cases in which borrowers succeed in bypassing constraints inserted in the covenants without having any repercussion. In other cases, borrowers are even incentivized to violate their obligations due to the fact that they are certain that lenders will not monitor or will not start legal proceedings to make the other part adhere to the conditions negotiated. Furthermore, as long as monitoring and contracts observance will remain expensive activities, free riders will still be able to take profit from others' audit activities. Those previous examples explain why some lenders feel the necessity to rely on financial intermediaries. Through making private financial transactions to circumvent free riders and

conducting strong monitoring and enforcement activities to keep borrower away from cheating, financial intermediaries are able to solve most of the troubles caused by moral hazard situation. As in the case of adverse selection, the study points out that financial intermediaries cover a crucial role in channeling funds from lenders to borrowers and prevent market inefficiencies such as asymmetric information.

1.2.2 Transaction costs

Transaction costs, time employed and the amount of money spent are considerable problems faced by lenders who want to invest into financial markets in order to generate an additional economic return. This concept is even more important when referring to lenders who have low financial availabilities.

Let's imagine an investor who have saved 10.000 € and who decides to invest his savings. Because of the scarcity of funds available, he has just few possibilities: one option may be to acquire a small number of shares into the stock market; another may be to buy a national bond; a third option may be to use online trading, even though brokerage commissions would reduce dramatically his earnings. Moreover, due to his low level of financial resources, this investor could probably make only a restricted number of investments and that fact would exposes him to the extra risk of not diversifying his portfolio.

For the reasons explained above, it is easy to understand how hard is to invest without being helped by professionals. For instance, financial intermediaries

are those kinds of specialists who allow even small lenders to benefit from investments into financial markets. Indeed, according to Williams, "*Transactions, by contrast, that are supported by significant investments in transaction specific assets and are subject to incompleteness (by reason of bounds on rationality) will experience miscoordination when beset by significant disturbances for which defection from cooperation can be projected as the stakes increase. Such transactions will benefit from unified ownership and coordinated adaptations as implemented by hierarchy.*"[10]

Financial intermediaries are able to break down transaction costs and take advantage even from low levels of financial resources through their matured expertise and the exploitation of economies of scale. On the one hand, investors who lean on financial intermediaries benefit from their expertise under several points of view: proficiency in liquidity services, competence in computer technology, deep knowledge of financial markets and great know-how about portfolio assets management. On the other hand, investors take profit from the fact that financial intermediaries bundle together the funds of many people in such a way that it is possible to take advantage of economies of scale. Indeed, putting together many small investors' savings gives the possibility to create a huge amount that is capable of reducing the transaction costs per individual. Furthermore,

[10] Williamson O. E., "Transaction cost economics: the natural progression", Prize lecture, 2009, pp. 465.

economies of scale are also significant for lowering the fixed costs made by financial institutions to start and accomplish their tasks (e.g., the set-up of an efficient telecommunication system that is going to be used for a high number of future transactions). Once these assumptions have been made, it comes out transparent how fundamental financial intermediaries are for exploiting economies of scale able to lower the risks and to generate a greater financial return.

1.2.3 Risk sharing

One more benefit given by the presence of financial intermediaries is the fact that brokerage helps investors reducing economic risk exposure. That practice is known as risk sharing. Substantially, financial intermediaries "*create and sell assets with risk characteristics that people are comfortable with, and the intermediaries then use the funds they acquire by selling these assets to purchase other assets that may have far more risk*"[11]. Because of low transaction costs just described, financial intermediaries share risk at a lower cost and take profit on the spread between the returns on higher-risk assets and the payment made on the assets that they have sold. Moreover, risk is taken under control by financial intermediaries through portfolio diversification strategies, which enable them to

[11] Frederic S. Mishkin, "The economics of money, banking, and financial markets", thirteenth edition, 2021, pp. 84.

diminish their investors' exposure to risk by investing in a varied basket of goods, services and financial assets.

1.2.4 Economies of scope and conflict of interests

The importance of financial intermediaries is also highlighted by the exploitation of economies of scope, which is another useful tool employed in financial transactions. According to Teece, "*economies of scope arise from inputs that are shared or utilized jointly without complete congestion*"[12]. Indeed, when financial intermediaries offer products like securities, bonds or bank loans, they reduce the information costs production by sharing the same information with many different investors.

For instance, before giving a loan to a certain firm, an intermediary evaluates how risky and how reliable that firm is under several points of view. Once the mediator has realized the firm is trustable, the loan will be delivered to the firm. Later on, the mediator will also sell that firm's securities to its clients since it is now confident of the reliability of the firm. This represents the case in which a mediator shares the information of a good and trustable company with its investors who are willing to buy the firm's securities.

Nevertheless, there are some cases that create conflicts of interests, ending

[12] Teece D. J., "Economies of scope and the scope of enterprise", Journal of Economic Behavior and Organization 1, 1980, pp. 226.

up with additional costs. Conflict of interests is a kind of moral hazard issue and it comes up when a subject has various interests, some of which deal with each other. This situation is more likely to occur if the subject under discussion offers multiple services, as in the case of financial institutions. Because of the existing contrasts among the various interests, individuals and/or firms who rely on financial institutions may decide to hide significant details or disclose deceptive information. On the whole, this provokes a lowering in the quality of data that feed the asymmetric information problems discussed above. As explained before, those unpleasant circumstances prevent the right functioning of financial markets, impede the financial transaction of funds and cut dramatically the number of investments made, coming to a less efficient financial system.

1.3 The changing nature of financial markets

The nature of each financial system depends on the way cash flows among the principal financial operators that are individuals, enterprises, public sector and foreign sector. This nature may vary a lot from region to region basing on cultural factors, geographical differences, political divergence, the level of financial development, the degree of openness of the economy and the modalities of financial intermediation.

This paragraph takes into account the changing nature of financial markets, which is a fundamental component that gives the reading key to understand the

evolution of financial intermediation. In particular, it is going to be analyzed the European financial system transformation, which has adopted peculiar characteristics of the U.S. financial system.

1.3.1 The traditional framework

Historically speaking, the European financial system has always been detached from the one of the United States. These two different financial systems are respectively known as 'relationship-based' system and 'arm's length-based' system. The former one widespread in the European economies, while the latter one thrived in the Anglo-Saxon economies.

In the relationship-based system, the bank is the central financial institution. There is a strong link between the enterprise and the bank since the latter keeps confidential the information of the former, provides funds and carries out investments. The result is the formation of a long-lasting relationship, which can be called 'customer relationship'. In this sense, the bank gathers private information regarding all its customers. This fact implies an asymmetry of information that confers to the bank not only a solid authority, but also a great power. Indeed, the bank has the strenght to deny or grant financial support to any potential customer. For these reasons, it may happen that the bank exerts a sort of monopolistic control over the financed companies, due to the huge mole of private information that it has stored. This financial system fits perfectly in scarce regulated and less transparent

markets that are distinguished by the high presence of small and medium enterprises (hereinafter also referred to as SMEs). This situation is very common in the European financial markets, especially in Southern European markets like the one of Italy. On the contrary, in the arm's length-based system, companies seek for financing funds directly onto the market. There are neither banks nor other financial intermediaries that play the role model for financial transactions. The pillars that uphold this system lies in the fact that information is not kept confidential but shared to the public. In such a way, each potential investor may be able to evaluate from himself the profitability of financing a determined business or enterprise. This financial system has developed mostly in those countries characterized by the predominance of large companies, where the market is wide, ground-breaking, well-regulated and transparent. These circumstances find favorable conditions to develop in countries like United Kingdom and United States[13]. The previous statements explained the characteristics and the functioning of those two different financial systems. Nevertheless, the financial framework has changed in the last few decades, especially in Europe, where the arm's length-based system has started overcoming the relationship-based system.

[13] Cf. Allen, F. e Gale, D., "Comparing Financial Systems", MIT Press, Cambridge MA, 2000.

1.3.2 New financial approach

The failure of the Bretton Woods system in 1971, the problematics caused by two oil crises in 1973 and in 1979 and the fact that companies started to finance themselves into foreign markets were some of the most relevant factors that triggered the transition from the relationship-based system to the arm's length-based system. Until 1980, European financial markets were prevalently limited to national boundaries and the bank was the most important figure in financing, as shown in the following *figure 2*. Indeed, it is visible the discrepancy between Anglo-American countries and European countries given by some indicators of financial development. The 'bank loan to private sector' indicator is the ratio of claims on private sector of deposit money banks and GDP, which reflects the way private companies financed themselves: European economies' score (0.601) almost doubles Anglo-American economies' one (0.315), a fact that reveals the close link between bank and companies in the old continent. In addition, the 'deposits' indicator is the ratio of commercial and savings bank deposits and GDP, which gives an idea of the level of invested capital, which is higher in countries such as the U.S. (0.540) and the U.K. (0.280) with respect to european mean (0.647); symptom of a more consistent flow of capital that is invested rather than being stagnant in banks' vaults. Last, the 'stock market capitalization' indicator expresses the aggregate market value of equity of domestic companies divided by GDP, so that an explanation of the degree of advancement of stock markets: in that case there

is a huge score difference between Anglo-American (0.420) and European (0.078) economies with the latter verging on zero.

Figure 2: Indicators of financial development (1980)

Country	Bank Loan to Private Sector	Deposits	Stock Market Cap.	Equity issues	N. of companies
AUSTRIA	0.742	0.682	0.030	0.000	8.740
BELGIUM	0.272	0.299	0.090	0.030	22.850
DENMARK	0.244	0.276	0.090	0.010	42.540
FINLAND	0.462	0.391	na	0.012	na
FRANCE	0.731	0.679	0.090	0.060	13.990
GERMANY	0.864	0.564	0.090	0.010	7.460
GREECE	0.520	0.507	0.085	na	na
IRELAND	0.315	0.577	na	na	na
ITALY	0.555	0.676	0.070	0.040	2.360
LUXEMBOURG	1.210	1.626	0.001	0.016	205.556
NETHERLANDS	0.632	0.602	0.190	0.010	15.120
PORTUGAL	0.855	0.946	0.006	na	na
SPAIN	.	0.723	0.087	0.028	13.213
SWEDEN	0.415	0.510	0.110	0.000	12.390
Average Cont. Europe	0.601	0.647	0.078	0.020	34.422
UK	0.276	0.280	0.380	0.040	47.220
US	0.354	0.540	0.460	0.040	23.110
Average Anglo-American	0.315	0.410	0.420	0.040	35.165

Source: Rajan R. and Zingales L. "Banks and markets: the changing character of european finance", National bureau of economic research, 2003.

On the whole, indicators exhibited in *figure 2* demonstrate the backwardness of the European countries as regards to financial development. Nonetheless, the former scenario started to change in the 1980s, when European countries began to evolute their financial systems.

European economies experienced the transition from the relationship-based system to the arm's length-based system, becoming more market-centered due to the conjunction of some favorable socio-economic events such as the formation of a stronger European government, the development of the international law, the improvements in the information flow and data report, the increase of international trade and capital movements[14]. Those particular circumstances found ground to change the financial picture of entire continent that went behind Anglo-American steps. For this purpose, the next chart, *figure 3,* represents the aforesaid situation twenty years later, exhibiting the changings occurred from year 1980 to year 2000. The abovementioned indicators evidence for European and Anglo-American economies a score of respectively 0.937 and 0.907 in bank loan to private sector, 0.930 and 0.724 in deposits and 1.046 and 1.694 in stock market capitalization. These data make it clear there was a strong increase with respect to the statistics of *figure* 2, suggesting a stronger market-oriented approach and a sort of convergence toward a financial system where the bank is no more the central institution.

[14] Cf. Rajan R. and Zingales L., "Banks and markets: the changing character of european finance", National bureau of economic research, 2003.

Figure 3: Indicators of financial development (2000)

Country	Bank Loan to Private Sector	Deposits	Stock Market Cap.	Equity issues	N. of companies
AUSTRIA	1.040	0.819	0.156	0.051	11.975
BELGIUM	0.792	0.837	0.783	0.138	15.707
DENMARK	.	.	0.686	0.192	42.135
FINLAND	0.534	0.464	2.383	0.497	29.730
FRANCE	0.864	0.636	1.087	0.145	13.720
GERMANY	1.207	0.925	0.668	0.065	9.071
GREECE	0.526	0.566	0.942	0.430	30.869
IRELAND	1.069	0.793	0.843	0.172	20.053
ITALY	0.770	0.514	0.703	0.041	5.058
LUXEMBOURG	1.099	3.367	1.771	0.494	122.727
NETHERLANDS	1.398	0.963	1.701	0.629	14.754
PORTUGAL	1.408	0.997	0.567	0.502	10.889
SPAIN	1.012	0.816	0.882	0.866	25.817
SWEDEN	0.457	0.391	1.476	0.289	32.920
Average Cont. Europe	0.937	0.930	1.046	0.322	27.530
UK	1.320	1.069	1.840	0.149	32.370
U.S.	0.493	0.379	1.549	0.207	25.847
Average Anglo-American	0.907	0.724	1.694	0.178	29.109

Source: Rajan R. and Zingales L. "Banks and markets: the changing character of european finance", National bureau of economic research, 2003.

As a consequence, the revolution brought by the advent of a new financial system created the conditions for the arise and the thrive of new figures of financial intermediaries. That was the response to the increasing demand for finding alternative ways of financing companies in such market-based economies.

1.3.3 Investment intermediaries

The evolution of the financial system led to the evolution of financial intermediation too. Nowadays, due to the changings occurred in the investment's landscape, financial intermediaries can be divided in three main categories that are depository institutions, contractual saving institutions and investment intermediaries.

Depository institutions are financial intermediaries that build deposits by gathering and conserving the money that privates and companies entrust them. Because of the huge historical amount of liquidity they possess, people rely on them to store their savings. Traditional banks, commercial banks and mutual savings banks fall into this first category. Deposit is their fundamental liability while loans, mortgages, national bonds and national securities are their principal assets. Investors who commit their money to this category are people who have a conservative behave in terms of financial risk.

Secondly, contractual savings institutions are financial intermediaries that collect money from people in order to protect them from the uncertainty of the future. Insurance companies and pension funds are that kind of institutions. The first ones acquire funds by selling insurance policies to people who pay the premium, investing in very liquid assets like large corporate stocks or bonds and national securities; the other ones operate with a contribution mechanism that bulk together part of employers' salaries into funds that purchase corporate stocks and

bonds to generate a surplus that will repay depositors once their retirement period comes.

The last category, investment intermediaries, is a large class that comprehend investment banks, mutual funds, hedge funds, finance companies and private market funds (born in the last decades). The principal liabilities of those financial intermediaries are shares, partnerships, stocks and bonds. Through these means they finance their activities that include a vast number of financial instruments: stocks, bonds, national securities, ETFs, futures, swaps, forwards, options, private and corporate loans, exchange in foreign currency, investment in real estate, buying debt of private companies and other exotic financial instruments. Despite the use of this or that financial tool, the final goal of all of those investment intermediaries is the same, so that to produce a constant and consistent economic return. Actually, investors who avail that kind of financial intermediation are willing to run medium or high-risk investments in exchange of the expectation of more significant profits[15].

[15] Frederic S. Mishkin, "The economics of money, banking, and financial markets", thirteenth edition, 2021, pp. 38 – 42.

Chapter 2 – Alternative investments in private markets

This second chapter sheds light over the world of alternative investments in private markets. The discussion covers the introduction of private market ecosystem, how they it is structured and the possibilities it gives in terms of alternative offers. Then, the analysis moves towards the study of the principal alternative private assets used to undertake investments, analyzing them under a benefit–drawback perspectives.

2.1 The private market ecosystem

The private market represents a particular ecosystem since it differs from the traditional public financial market. The principal differences between them concern pricing, liquidity and monitoring. To start, in public listed markets, shares are influenced by market fluctuations, so that prices change frequently either upwards or downwards. On the contrary, prices of private shares are stable: not being correlated with public financial markets, they are based on the negotiation between the owner of the company and the investor. Secondly, public shares are continuously traded on financial markets, being them very liquid. On the opposite stand private shares, which are considered illiquid given that an investor, in order to exit and take profit from his investment, needs to find another investor who is willing to buy his assets. At last, public financial markets present a high level of regulation and monitoring by national and international institutions, such as

CONSOB in Italy, ESMA in Europe or SEC in U.S., which guarantee transparency and the correct course of financial transactions. Instead, the only one protection for investments in private markets is given by the contract signed between the two parties[16].

The idea behind investing in private markets is that of differentiating the gamma of portfolio assets and getting expected higher returns. Moreover, investors are going to support non-listed, high-potential companies that may find difficulties in getting funds from banks or other traditional financial lenders. For instance, start-ups, early growing or expanding businesses, which regard the largest part of transactions in private investments, are that untrustworthy companies in terms of financial reliability. Banks feel often safer to proceed with the more conservative approach of not borrowing money to those firms in their first stages of life unless they satisfy a particular return-risk profile. This is why investments in private markets are often made through specific funds that are detached from the traditional bank system.

Private markets follow non-listed companies' lifecycle and help them growing using different financial instruments. Although the majority of transactions concern private equity, there are other common instruments that can be used to differentiate the gamma of investment, that are private debt and private real assets.

[16] Cf. Caselli S., Negri G., "Private equity and venture capital in Europe: markets, techniques and deals", Second edition, 2018.

The decision of using one or another financial instrument is based on several factors, like the investor financial profile, the stage of maturity of the company, the trend of the sector in which the company operates or the ongoing status of the economy in a certain country or financial market.

Private markets are upheld by the interaction among three figures that are fund investors, fund managers and entrepreneurs. Each player has his own interests depending on the perspective, nonetheless all of them are essential for the right course of investments in private markets. On the one side, there are fund investors, so that people who invest with the expectation of generating a future financial return. Investors differ from each another according to their risk-return profile. Investing in private markets is actually a risky activity that is usually pursued by those ones who want to diversify their portfolio and seek for higher returns. Since direct investing requires, in general, a matured know-how and a deep proficiency, it may reveal tough for savers to execute private capital investments, given the obstacles to face in private markets. Considering that investing in non-listed companies demands a long series of competences, the vast majority of lenders lean on professionals (fund managers in this case). On the other side, there are entrepreneurs and their companies, whose are the final targets of private equity funds. Entrepreneurs receives both financial and non-financial resources, such as the active participation of fund managers that help the business growing. Finally, fund managers, who stand in the middle, cover the crucial intermediation role of

monitoring and supporting entrepreneurs' business and reporting performances to investors. According to Cyril Demaria, "*knowing applicable regulations, being connected to the right network to generate investment opportunities and understanding the local business culture is crucial to succeed in what remains one of the riskiest investment activities. Among the obstacles to overcome, besides the competition between investors, are the lack of transparency of private companies and assets, the asymmetry of information between entrepreneurs and investors, and the limited and modest protection offered to investors (notably minority investors) in private companies when compared to investors' rights in listed companies. On top of these common factors, each PM strategy has its own requirements, such as an industry expertise (VC financing start-ups) or an aptitude to restructure a company (distressed debt and turnaround capital investing)*"[17]. As a result, in order to get profitable performances, fund managers are prompted to bring their expertise within the companies they are investing into. The previous statements point out how private markets necessitate for a constant monitoring and a systematic presence on the field to assist companies' operations. For all of these reasons, it is crystal clear how private capital represents an active investment rather than a passive one; in addition, the fact that investors rely on fund managers to administrate their portfolio

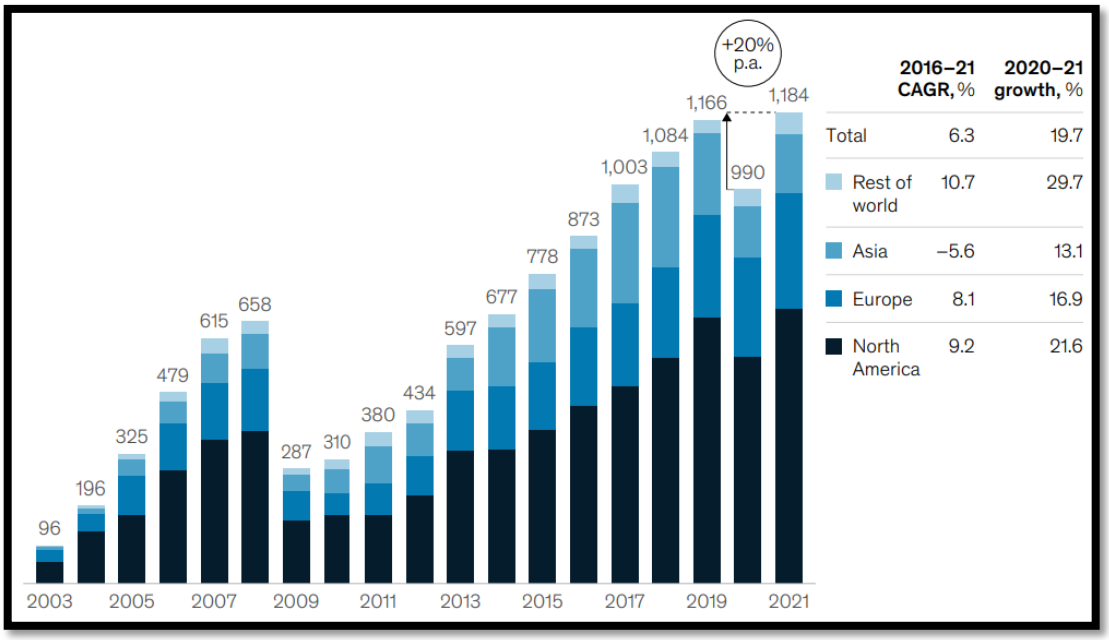
[17] Demaria C., Pedergnana M., He R., Rissi R., Debrand S., "Asset allocation and private markets: a guide to investing with private equity, private debt and private real assets", First edition, 2021, pp 57.

and doing their interests is the demonstration of how vital financial intermediaries are in private markets.

2.1.1 Global statistics

To give the idea of the vastness private markets cover in terms of capital fundraising it can be useful to provide some data. F*igure 4* depicts a complete picture of the total private markets fundraised capital from 2003 until 2021.

Figure 4: Total private markets fundraising through time divided by world region[1] ($ billion)



[1] *Excluding secondaries, funds of funds, and co-investments vehicles to avoid double counting of fundraised capital*

Source: McKinsey Global Private Markets Review 2022, "Private markets rally to new heights"

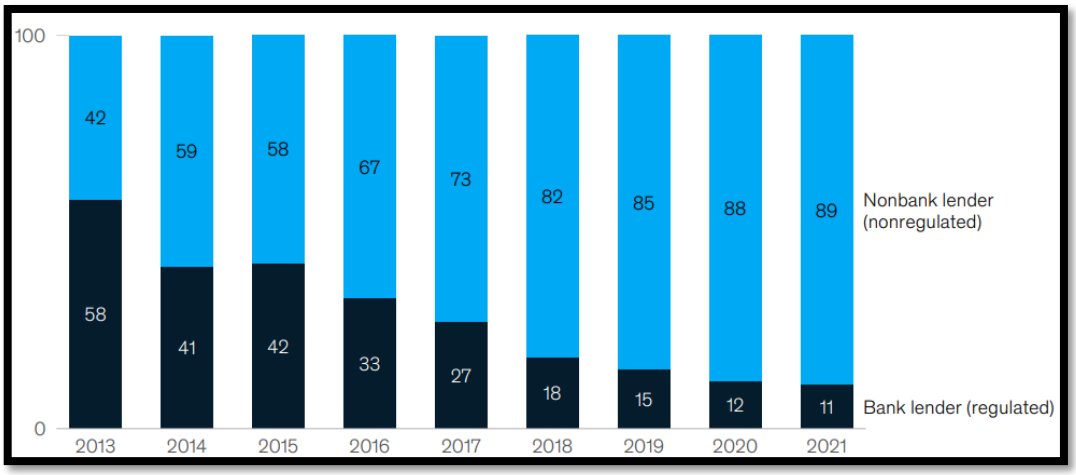
From the previous chart it is appreciable the increasing trend of private markets fundraising globally. In particular, statistics on the right reveal a positive course regarding the last quinquennium: the global fundraised capital had a compound annual interest rate (hereinafter also referred to as CAGR) of 6.3% and in the last year (2021) capital invested in private markets got the highest peak of 1,184 billion $. Those ones are great accomplishments considering the crisis caused by the Pandemic that widespread all over the world. Asia is the only one continent to register a negative trend in the last five years, while North America, Europe and the rest of the World experienced an important growth. Another interesting point is the study of the fundraising's composition, which is divided by world region. North America counts for more than 50% of the total fundraised capital in each year taken into account: that explains the great importance it gives to investments in private markets, especially for what concerns the United States. Then, Europe, which is following a positive trend, stands in the second place, surpassing Asia that places third due to the recent contraction. The last position is occupied by the Rest of the World that, despite the small amount of fundraised capital, it is experimenting a very fast growth in terms of capital invested.

From the analysis of the graph, it can be said that placing capital in private markets is considered a robust investment. Nineteen years of analysis demonstrates that the only two cases of decline coincide with the Global Financial Crisis occurred in 2009 and the Coronavirus Pandemic occurred in 2020. Nevertheless, in both

cases private markets fundraising restarted again, reaching even higher spikes in just few times.

This reveals the tendency investors have to place part of their assets toward private capital, rather than having exclusively public investments; at the same pace, many companies prefer to remain private instead of going public. The next chart, *figure 5*, highlight the situation that has just been described. Here it is crystal clear the tendency companies (especially SMEs) have to lean on non-regulated borrowers such as private funds. During the last nine years, the scissors have widened in favor of non-bank lenders that appetized investors much more than banks did. Indeed, in 2013, banks were involved in the 58% of deals for what concern the middle-market, while in 2021 just 11%. That suggest a strong financing revolution.

Figure 5: Percentage of deals by lender type in middle-market (2013 – 2020)



Source: McKinsey Global Private Markets Review 2022, "Private markets rally to new heights"

This particular trend has been noted to the point that Commissioner Allison Herren Lee intervened with a speech at the SEC stating that: *"the fact that more capital is now being raised in private markets means that a burgeoning portion of the U.S. economy itself is going dark. Twenty years ago, private markets represented (by some estimates) roughly two percent of global investable equity assets. Today, that percentage has increased more than threefold to a current estimate of seven percent. Other estimates reflect that global private equity net asset values have grown twice as fast as public market capitalization in the new millennium, with that trend expected to continue"*[18].

Given the huge amount of capital invested in private market, it was interesting to study the way that capital has been invested and which kind of assets have been employed. In this regard, the following *figure 6* illustrates the 2021 capital invested in some of the major private market financial instruments: private equity, real estate, private debt and natural resources and infrastructure. Also in this case, a geographical division has been used to highlight the way capital invested is divided among world continents.

[18] Commissioner Allison Herren Lee, "Going Dark: The Growth of Private Markets and the Impact on Investors and the Economy", SEC speech, Oct. 12, 2021.

Figure 6: Private market 2021 fundraising by asset class divided by world region[1]

			Asset class			
		Private markets	Private equity	Real estate[2]	Private debt	Natural resources and infrastructure
North America	Total, $ billion	**688.8**	**400.4**	**119.6**	**123.4**	**45.5**
	2020–21, $ billion	122.3	79.3	38.8	13.4	–9.2
	YoY change, %	21.6	24.7	48.0	12.2	–16.8
Europe	Total, $ billion	**293.1**	**134.1**	**28.2**	**56.7**	**74.1**
	2020–21, $ billion	42.5	15.8	–13.5	5.6	34.6
	YoY change, %	16.9	13.3	–32.3	10.9	87.7
Asia	Total, $ billion	**147.7**	**111.7**	**20.2**	**9.2**	**6.6**
	2020–21, $ billion	17.1	17.6	0.9	–0.8	–0.6
	YoY change, %	13.1	18.7	4.8	–7.9	–8.6
Rest of world	Total, $ billion	**54.7**	**33.5**	**7.5**	**2.7**	**10.9**
	2020–21, $ billion	12.5	11.5	0.2	0.0	0.8
	YoY change, %	29.7	52.4	2.4	–0.1	8.1
Global	Total, $ billion	**1,184.3**	**679.9**	**175.5**	**192.0**	**137.1**
	2020–21, $ billion	194.4	124.3	26.4	18.2	25.7
	YoY change, %	19.7	22.4	17.7	10.5	23.0

[1] *Excludes secondaries, funds of funds, and co-investment vehicles to avoid double counting of fundraised capital.*

[2] *Closed-end funds that invest in property. Includes core, core-plus, distressed, opportunistic, and value-added real estate, as well as real-estate debt funds.*

Source: McKinsey Global Private Markets Review 2022, "Private markets rally to new heights"

What comes out from the analysis of *figure 6* is that private equity represents the most attractive asset to pursue investments in private markets. Then, private debt and real estate places remarkably close to each other, with the former slightly higher than the latter. Finally, natural resources and infrastructure occupies the last spot. Behind the absolute numbers, it is very intriguing to go deeper and look at the year

over year change, which is a statistic that expresses the change in percentage from the previous year (may it be positive or negative). What is curious it is the different approach used by world regions in relation to different asset classes. All of them are increasing the capital invested in private equity, symptom of the fact that it is probably the best instrument to employ in this particular market. Instead, the discussion varies when looking at the natural resources and infrastructure class. Although the positive global trend there is a division between those ones who place funds in this asset and those who don't. For instance, Europe is concentrating a good part of its resources in that category, evidencing an astonishing 87.7% increase; similarly Rest of the World has augmented by a fair 8%. Those regions are presumably addressing their investments toward the idea of a green economy able to support a more sustainable financial ecosystem, while North America and Asia are not. Indeed, those two continents show a decreasing trend in this asset class, revealing respectively a -16.8% and a -8.6%.

Other significant mentions need to be done in regard to the real estate and private debt asset classes. For what concern the former, north America believes a lot in it, demonstrated by its impressive 48.0% rise; on the contrary, Europe experienced a contraction with a -32.3%, probably due to the decision of investing in other assets like natural resources and infrastructure; for their part, Asia and Rest of the World did not make relevant changes. In regard to private debt, which is the second higher form of private investment, it can be said that both North America

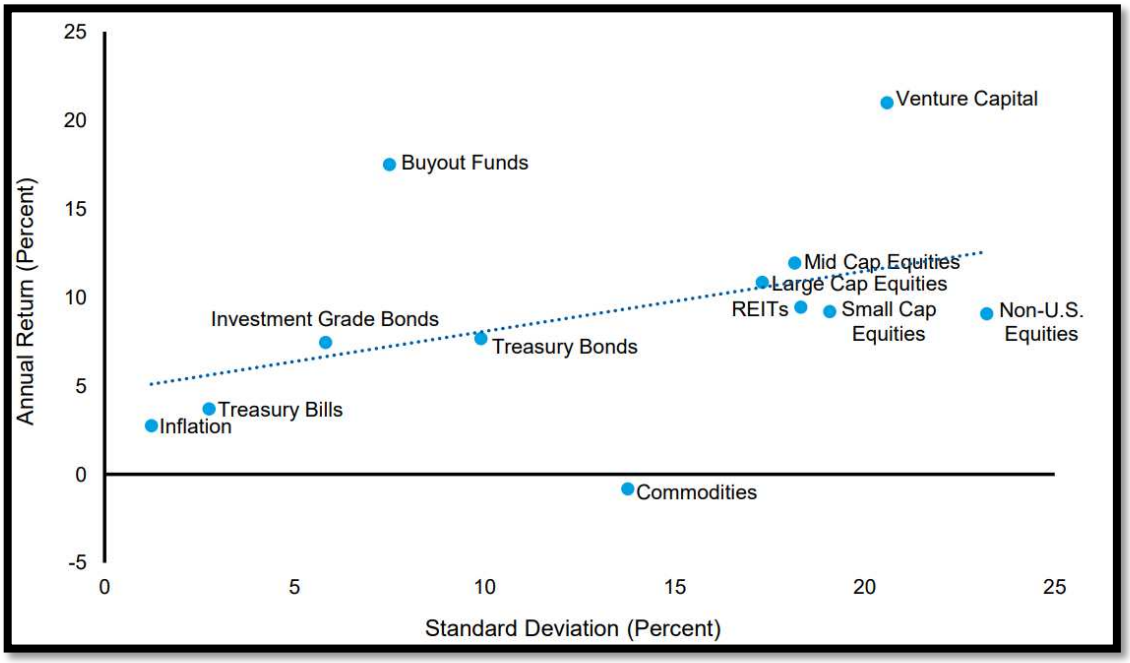
and Europe have boosted the capital invested in it (respectively 12.2% and 10.9%), while Asia has experienced a negative trend (-7.9%) and Rest of the World has not changed relevantly.

2.1.2 Benefits

Investors are attracted by private markets because of the benefits they can get from. The drivers that draw new capitals in private markets are performances and diversification. The first one regards the fact that private investments are expected to generate relevant financial returns despite of an increasing level of risk. The second one concerns investors portfolio strategies, considering private assets as a good alternative to the traditional 60/40 portfolio construction. Indeed, Michael Mackenzie and Ye Xie stated that *"investors had been exploring ways to shift away from that approach (60/40 portfolio). Some have advocated downgrading the bond component as high-quality fixed-rate yields are less than the current inflation rate, eroding the purchasing power of the returns. A shift away from expensive U.S. large cap shares toward those of smaller and lower-valued companies in global markets – such as the U.K., Europe and the developing world – have also been recommended. Another approach has been tying up money for extended periods in*

the booming private debt markets, in an effort to find assets that are less correlated with those of publicly traded shares and bonds"[19].

Figure 7: Asset class risk-return profile (1984 – 2015)



Source: Morgan Stanley, "Public to Private Equity in the United States: A Long-Term Look"

Figure 7 plots the risk-return profile of several asset classes within a 32-year-long timespan (from 1984 until 2015). The X-axis indicates the standard deviation, which is a measure of risk, while the Y-axis specifies the annual return;

[19] Michael Mackenzie and Ye Xie, "The 60/40 Portfolio Has Worst Loss Since March 2020 on Fed", Bloomberg, January 31, 2022.

that with the aim of the showing the profitability linked to the risk of running an investment. It comes out very clear how private equity assets such as venture capital and buyout funds distinguish themselves from the traditional forms of investments like large cap equities or treasury bonds. In particular, venture capital places itself in the up-right corner, being the most rewarding and the second-highest risk investment at the same time. Besides, buyout funds highlight the second-highest return and the fourth position in terms of risk, features that makes it one of the best asset classes in this classification. Nonetheless, given the extraordinary performances of those private capital instruments, some academics have wondered about the accuracy of those statistics. Indeed, they casted doubt over the way private equity funds managers reports data and profits[20], stating that they are not fully convinced about the risks. However, those statistics evidence how investor's profile is called to an evolution as a consequence of the changings happening in nowadays revolutionized financial systems. Investments that have driven economic growth in the last decades may no longer be as profitable as in the past, therefore the research of alternative investments to substitute the older and more obsolete ones. Time adaptation and renovation are the reasons behind this great private capital fundraising that pass-through drivers like performances and diversification.

[20] Antti Ilmanen, Swati Chandra, and Nicholas McQuinn, "Demystifying Illiquid Assets: Expected Returns for Private Equity," Journal of Alternative Investments, Vol. 22, No, 3, Winter 2020.

2.1.2.1 Performances

Private market performances are measured through specific metrics that state how good private investments are and how they perform. In some cases, it is possible to make comparison with other traditional financial instruments such as public equities, bonds or commodities that refer to the public market: that to give an idea of private markets' yields.

There are three main indexes that are used to measure performances of investments in private market: the internal rate of return (hereinafter also referred as to IRR), the multiple of invested capital (hereinafter also referred as to MOIC) and the public market equivalent (hereinafter also referred as to PME). All of them show pros and cons; so that, the initial assumption observe that they should be used in combination in order to fully analyze private market funds' performances and to get a global detailed picture of private capital investments.

The IRR is one of the most important performance benchmarks in the field of private investments, which gives investors a way to compare the profitability of similar assets through a percentage that express the effect of time on investments. In a nutshell, it shows the most attractive project in a given time frame[21]. The IRR is expressed by the following formula:

[21] Cf. Marc Goedhart, Cindy Levy, and Paul Morgan, "A better way to understand internal rate of return", McKinsey and Company, November 1, 2015.

$$0 = \mathrm{NPV} = \sum_{t=1}^{T} \frac{C_t}{(1 + \mathrm{IRR})^t} - C_0$$

Where:

- C_t = Net cash inflow during period t
- C_0 = Total initial investment costs
- IRR = Internal rate of return
- t = number of time periods.

Being the IRR expressed in percentage is easier to compare to the required cost of capital. Moreover, it should provide an excellent guidance on a project's value and associated risk. Finally, the IRR method gives you the advantage of knowing the actual returns of the money which you invested today. Nevertheless, the IRR reveals some downsides:

1. The IRR is a time-sensitive measure that can be manipulated to some extent. Indeed, private equity fund managers may alter the IRR cashing out as soon as possible in order to magnify the fund's performance;
2. The IRR does not consider the context of the investment. Extraordinary favorable economic conditions in a particular time period may result in an outstanding performance even without much effort;
3. The IRR evaluates the capital invested rather than the capital committed. A private equity fund invests only a part of the capital it receives because a

percentage of that capital is going to finance the fund itself. For this reason, the IRR's measure takes into account only the invested capital, which is less than the total given to the fund[22].

On the basis of the previous statements, it comes out that investors should consider the IRR as a relevant benchmark; nonetheless, they should also look for details over the IRR's calculation and they should also combine this meter together with other measures such as MOIC or PME in order to have a complete and deepened study of the investment.

The MOIC is another common meter to analyze private market funds and their performances. It is an important reference because of his strenght point of focusing on funds' absolute performances. The MOIC metrics is expressed in "multiples of" and it is represented by an ×. For instance, a lender who invests $1 million and gets back a $10 million return would have a MOIC calculation of 10×, since he has multiplied his initial invested capital by 10 times (1.0× is the case of an investment that has just broken the even point). Nonetheless, one relevant consideration to be done is that MOIC does not take into account the period of the investment but just the absolute profitability behind it. Indeed, what MOIC considers is the final amount received by the investor without telling the time employed to run the investment itself: whether it is a 5 or 10 years investment period

[22] Cf. Rabaya Bosri, "Evaluation of Managerial Techniques: NPV and IRR", UITS journal, vol – 5, issue – 1.

the MOIC score will remain 10×. MOIC strenght points are the fact that it regards absolute performances and it is independent to the amounts used as a basis of calculation. Those peculiar characteristics not only facilitate the comparisons of fund performances a, but also make it difficult to manipulate statistics. In particular, this last fact makes the MOIC metric very appetible for investor who want to rely on a robust performance indicator. Nonetheless, because of his particular construction, MOIC also presents some drawbacks:

1. MOIC does not take into consideration the effect of time on investments. The MOIC score cannot be easily annualized and, therefore, it may be difficult to compare performances of the interested asset class (e.g., a private equity fund) with other asset classes (e.g., a public company market appreciation);
2. As previously said for IRR, also MOIC does not include the context of investment in its computation. Hence, investors have to analyze from themselves the performance of funds looking at the macroeconomic conditions of the financial system in order to understand the real profitability of investments;
3. The MOIC metric considers the capital invested and not the capital committed. Thus, fund investors should apply specific computations to

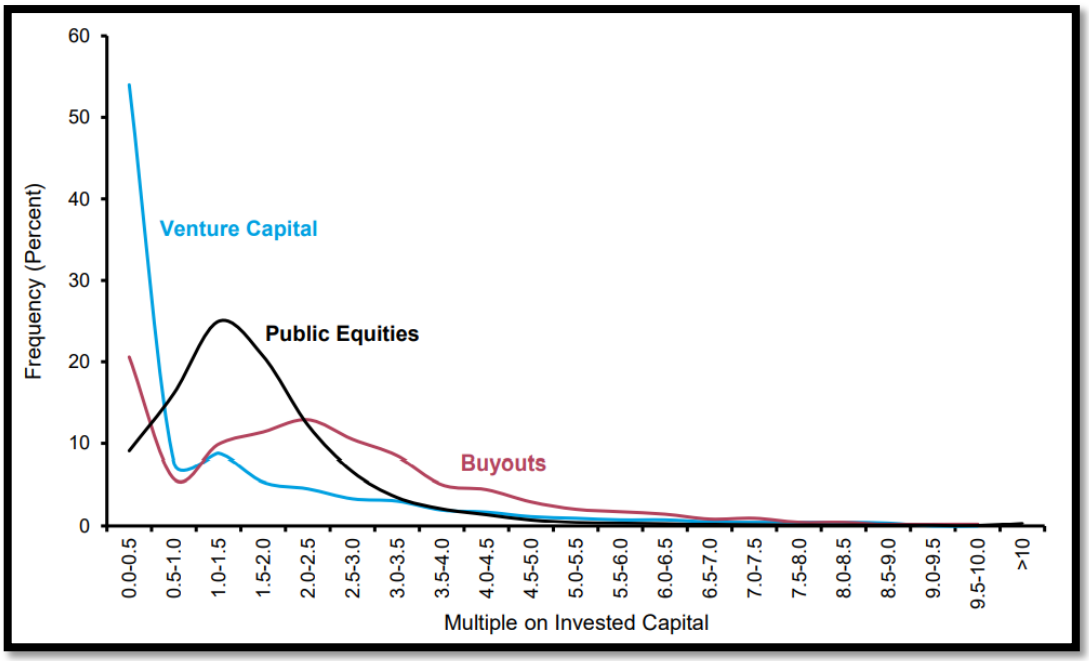
integrate opportunity costs and costs of capital in the overall performance analysis based on MOIC[23].

Below, *figure 8* provides an example of the MOIC metric, which is implemented to compare private and public equities. According to Morgan Stanley, the graph "*examines the multiple on invested capital for 15,000 global buyout investments and 30,000 global venture capital investments, mostly from the mid-1990s to 2018. It also shows about 30,000 observations of 5-year returns for stocks in the Russell 1000, generated by collecting thirty increments of 5-year returns from year-end 1985 through year-end 2019. We selected a five-year horizon for public equities because it is roughly in line with the average hold*[24]". *Figure 8* suggests that venture capital has the greater proportion of failed investment, even though the few that succeed have the highest level of return. In a nutshell, the majority of investments lose or, at most, reach the even point while the top 20% earns a lot. Instead, buyout investments show a totally different curve: although they still have more failed investments than public market, buyout funds investments are more consistent as financial returns raise. Indeed, they overperform public equities from the third quintile on, reaching even higher peaks. Public equities reveal themselves to be a

[23] Cf. Demaria C., Pedergnana M., He R., Rissi R., Debrand S., "Asset allocation and private markets: a guide to investing with private equity, private debt and private real assets", First edition, 2021, pp 70 – 75.
[24] Michael J. Mauboussin, Dan Callahan, written for Morgan Stanley counterpoint global insight, "Public to Private Equity in the United States: A Long-Term Look", 2020.

quite safe investment if compared to venture capital and buyouts. The public market has a fewer percentage of wrong investments and a discreet level of return, even though they dramatically fall as the MOIC measure goes beyond 1.5× or 2.0×.

Figure 8: Returns' distribution in public equities, buyouts, and venture capital



Source: Morgan Stanley, "Public to Private Equity in the United States: A Long-Term Look"

On the whole, the MOIC measurement represents an appreciable tool to analyze investments in private markets, comparing them with the ones of public market. Nevertheless, as is the case of IRR, MOIC shows some drawbacks that may influence the evaluation. In this perspective, it would be more significant to use the

MOIC measurement in combination with other metrics that are able to counterbalance its weak sides.

The PME is a further important index used to measure and compare performances of public markets' investments with the ones of private equity funds. It is a recent method designed as a response to the critics advanced toward the inconsistency of IRR and MOIC. This metric is also known as the Index Comparison Method (ICM): initially formalized by Long and Nickels in 1993, it was discussed and modified many authors like Rouvinez in 2004, Kaplan and Schoar in 2005 and finally Kocis in 2009. Every one of them gave his own contribute to finding a way to modernize and improve the ICM; nonetheless, according to Demaria, the best result was reached by Cambridge Associates, who have formulated the "modified Public Market Equivalent" (mPME). It is a private to public comparison that measures the possible returns achievable in the case the money invested in private capital would have been invested in public capital. About the functioning of mPME, Cambridge Associates stated that "*Private investment contributions are invested "on paper" in a chosen public market index and distributions are taken out in the same proportion as in the private investment. With each distribution, mPME "sells" the same proportion of the dollar value of shares owned by the public equivalent as the private investment sells in private shares. […] If the private fund's returns exceed the mPME returns, the private fund has*

added value relative to the public market. Investors are then in a better position to judge whether or not the value added by the private fund was sufficient to offset the illiquid nature of the investment[25]". The advantages that derive from using the PME index regard, first of all, the fact that it considers the context of investments since it takes a listed index as a benchmark; secondly, PME eliminates the time sensitives issue, also known as liquidity problem, by setting a determined period of time for comparing private investments to public investments. Notwithstanding that mPME solves some of the problems related to the faults of the other metrics in measuring private market performances, it is true that it also has some shortcomings:

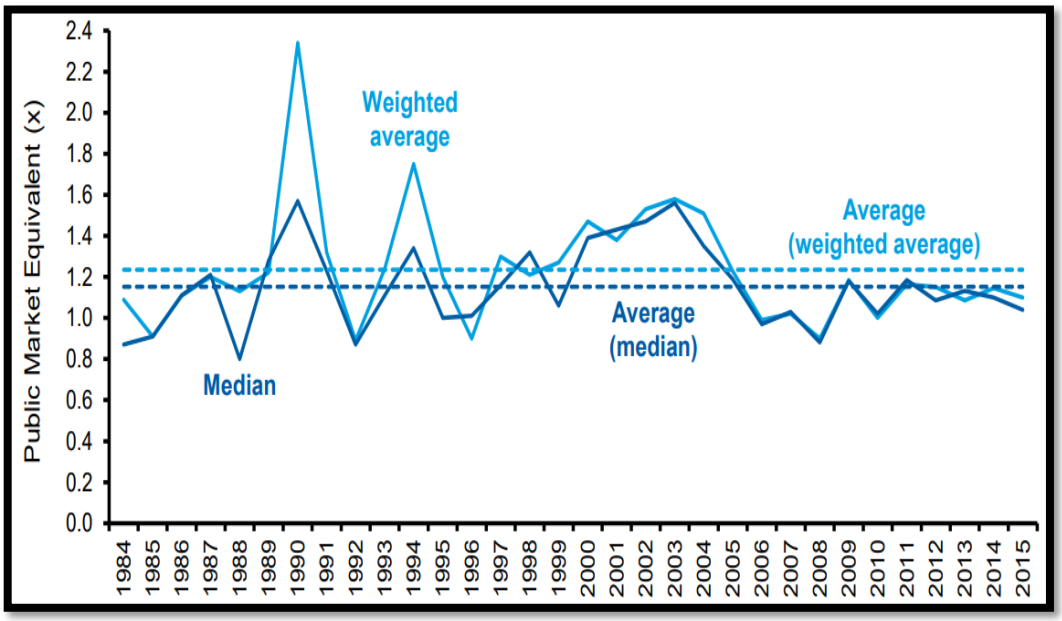
1. The PME is very sensitive to the index chosen to evaluate performances, so that it may reveal tough to find an index which is able to benchmark some particular strategies like private debt or private real assets;
2. Comparing private markets to public markets has a rare complexity in countries that present a scarce regulated financial context with a low level of market equivalents. That's the case of many backward countries that have poor financial markets;
3. The PME does not take into account the performance drags provoked by uncalled capital. As it is true that this problem may be fixed by assuming that the 100% of the capital is committed at the beginning of the private

[25] Cambridge Associates, "About Our Private Investment Benchmarks", 2014.

market fund's life, it is also true that this solution entails other problems related to the investment process of the private market funds (e.g., the case in which the fund does not fully invest the capital it received).

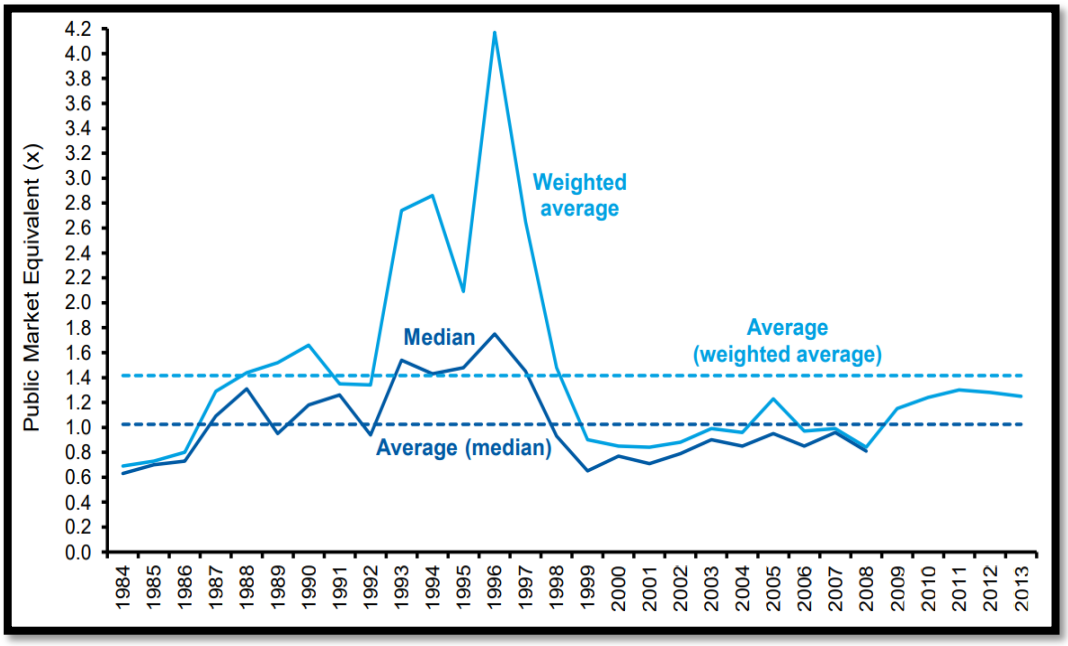
Examples of PME used to evaluate private investments and compare them to public ones are visible in the following charts, *figure 9* and *figure 10*. Morgan Stanley has benchmarked U.S. buyout funds and U.S. venture capital funds to public market equivalents that share similar characteristic. Then, it has computed the median and the weighted average for a 30-years-time horizon.

Figure 9: Public Market Equivalent index, returns for U.S. Buyout Funds (1984 – 2015)



Source: Morgan Stanley, "Public to Private Equity in the United States: A Long-Term Look"

Figure 10: Public Market Equivalent index, returns for U.S. Venture Capital Funds (1984 – 2013)



Source: Morgan Stanley, "Public to Private Equity in the United States: A Long-Term Look"

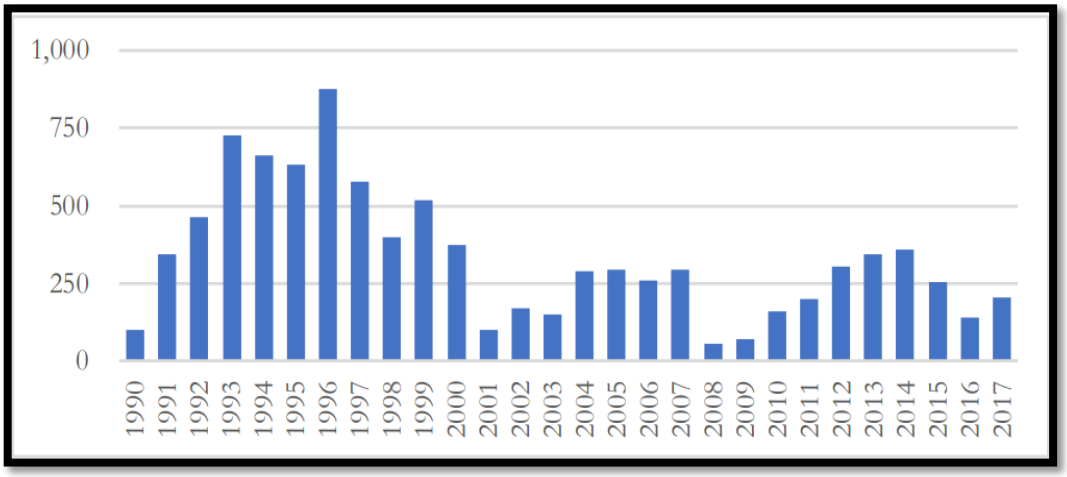
Generally speaking, the PME index can be expressed as the ratio of private capital and public capital returns. So that, from the previous graphs it is intelligible that a score greater than 1 means an overperformance of private investments, while lower than 1 the contrary. Both buyout funds and venture capital funds evidence great results, being their average median and average weighted average respectively 1.1 and 1.2 for buyouts and 1.0 and 1.4 for venture capital. Hence, to conclude, statistics like that suggest an overperformance of private capital investments over public capital investment in a long run perspective.

2.1.2.2 Diversification

Investors are interested in approaching private markets also because of the large diversification possibilities that it offers. To start, the private market ecosystem is a much wider universe if compared with stock exchange markets in terms of absolute numbers. Companies listed in public markets are much less than the infinite number of private companies operating in each sector of the economy. Furthermore, as a matter of fact, statistics reveal a stationary if not even decreasing trend in the quantity of companies which decide to go public. According to Marshall Lux and Jack Pead, "*the IPO market can be viewed from a variety of perspectives, including by the number of IPOs and the total amount of capital raised. These results can be segmented by size or sector. Looking at the market as a whole, since 2000 the average number of IPOs annually has fallen by over 60% from the levels seen during the 1990s"*. Here the United states' market has been taken as reference since it can be considered the most important financial market in the world. That fact is highlighted in *Figure 11*, which shows how the number of initial public offerings has dramatically fallen since year 2000. The following graph embodies the end of an IPO expansion that characterized the U.S. financial market in the last decade the 20th century. Moreover, it is appreciable the fact that during the last 18

years the number of IPOs remained very low, symptom that many companies preferred to remain private rather than going public[26].

Figure 11: Number of IPOs in U.S. (1990 – 2017)



Source: Marshall Lux and Jack Pead, "Hunting High and Low: The Decline of the Small IPO and Wat to Do About It"

Despite the huge number of private companies available, not necessary every one of them constitutes an optimal target under an investment perspective. Simultaneously, the same speech can be applied for listed companies, so that, for transitivity, the private market investment universe is the larger than the public's one.

[26] Cf. Marshall Lux and Jack Pead, "Hunting High and Low: The Decline of the Small IPO and What to Do About It", Mossavar-Rahmani Center for Business & Government Harvard Kennedy School, 2018, pp. 3-8.

Secondly, the variety of industries that private markets funds is able to finance is much more assorted with respect to the one of the stock exchanges. Indeed, in addition to the current profitable economic industries, private equity funds often approach high-potential (consequently also riskier) sectors of the economy, given that their principal forms of investment are buyouts or venture capital. In the first case, the attention focuses primarily on niche markets, hence those business that at the present time don't attract the public attention: it may be the case of the LGBT community, the sector of professional gaming, the vegan portion of the people or the fitness world. In the other case, venture capital concentrates on emerging industries that may shocking in the near future: examples could be the advanced artificial intelligence, the enhanced virtual reality, the automobile sector towards driverless cars or the biotechnology and genomics industry.

In the third place, private market funds cover several financial aspects of the companies they are investing into, from financing the equity exigency of a company to offering asset-financing solutions or even reengineering capital structures and liquidities. Moreover, private markets funds follow companies' lifecycle, giving them support in every stage of their existences, starting with the inception, going through the renovation and ending up with the liquidation. Conversely, the traditional financial markets have revealed the tendency to finance just mature assets which have particular characteristics and a considerable size in order to run

secure investments. The truth resides in the fact that private market companies can't be financed using the same identical instruments employed for public companies. Private companies, indeed, need a high level of personal involvement and a compages of truly patient and motivated investors who are willing to wait the company to grow. In a nutshell, private equity funds give investors the possibility to acquire exposure to a new range of economic sectors that they could not be able to approach otherwise, thus adding a very significant element such as the portfolio diversification[27].

In the last analysis, private market funds provide investors a more expansive geographical sight, involving in the investment process less developed and emerging countries with scarce – in some cases even without – a stock exchange system. Reporting Demaria remarks, "*as long as the legal, cultural, and entrepreneurial frameworks are in place and rights can be enforced, there is ground for applying some form of PM investment strategies. The financial and legal expertise, as well as the local financial and physical infrastructure, are in essence the main limits to the development of this kind of activity*"[28].

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[27] Cf. Nadauld, Taylor, Berk Sensoy, Keith Vorkink, and Michael Weisbach, "The Liquidity Cost of Private Equity Investments: Evidence from Secondary Market Transactions," Journal of Financial Economics, 2017, pp. 158–181.

[28] Demaria C., Pedergnana M., He R., Rissi R., Debrand S., "Asset allocation and private markets: a guide to investing with private equity, private debt and private real assets", First edition, 2021, pp 85.

2.1.3 Challenges

Private markets embody alternative investment opportunities, which are very appetible to those investors who seek for higher return perspectives and portfolio diversification. The downside of these assets is connected to the risks behind the exposure to poorly regulated and less transparent markets. In the previous paragraph the benefit linked to private capital investments were stated; now the argumentation moves to the challenges of making them.

There are many threats related to the activity of holding private market capitals. In the first chapter, it was analyzed the information issue; in this paragraph, the discussion focuses other downsides such as funding risk, market risk, liquidity risk, capital risk and leverage risk that are some of the main hazards concealed in private markets investments.

Funding risk, also known as default risk, is the risk linked to the impossibility an investor has to pay his capital commitments in accordance with the terms stipulated with a private market fund. On the basis of conventional limited partnership accordance (LPA) rules, an investor who is uncapable of meeting capital calls may lose his full investment. That's why it is fundamental that investors manage their cash flows in a way they can satisfy their LPA obligations at any time. Funding risk mostly occurs in situations of over-commitment or market turmoil. In the former case, over-committing is an investors' strategy that involves making excess capital commitments in order to invest as much capital as possible in the first

solution. That tactic is employed to minimize the unfavorable effect of cash drag on returns; however, it may deal with a liquidity problem once the cash for another capital call is due. In the other case, market turmoil refers to the circumstance that capital redistributions miss because of external factors such as underperforming companies or financial crisis. Given that investors usually exploit capital redistributions to finance future funds' capital calls, market turbulences may compromise the plan. Therefore, it ends up with the funding risk or, even worse, the risk of default.

Liquidity risk regards the difficulty an investor has in getting out from a private investment at the time of his choice. Private market funds are designed to be medium-long term vehicles –usually lasting 8 to 15 years – that prompt investors to hold their assets for the entire life of the fund. As a consequence, it has born and evolved a secondary market for trading participations. Nonetheless, the secondary market usually doesn't offer a vast gamma of trading opportunities, being it relatively small and highly inefficient. Because of a low volume of trade, the demand can't meet the supply for a fair value, thus resulting in a liquidity problem. According to Christian Diller and Christoph Jäckel, "*the secondary market is not a liquid market efficiently setting "prices" as can be found in any listed market from quoted shares. Even though the secondary market volumes have increased over the last years and volumes have reached a record level of around USD 40 billion in*

2014, it is still only 3% to 5% of the primary volume"[29]. However, the previous statement is the demonstration of how the secondary market is gradually expanding, also thanks to the presence of financial intermediaries. Indeed, these actors decrease market deficiencies by providing high quality information and financial competence to investors. Given those assumptions, it can be stated that all the players involved in private markets investments are trying to figure out a way to solve the liquidity problem, even though, nowadays, it still remains a significant issue to deal with.

Market risk is associated with many forms of threats that may affect investments such as foreign exchange, geographical/sector exposure or interest rates and markets' trends. Theoretically speaking, private assets (e.g., private equities) should not suffer market fluctuations because of their characteristic of being decorrelated from listed financial markets; in practice, they could be indirectly influenced by public markets. Moreover, they could be exposed to other threats such as inflation risk. Indeed, as private market funds invest capitals over the course of five to eight years, there is the possibility that the inflation's increase compromise financial revenues. Obviously, strategies like using variable interest rate are implemented by private market funds to counter such unpleasant

[29] Christian Diller, Christoph Jäckel, "Risk in Private Equity – New insights into the risk of a portfolio of private equity funds", British Private Equity & Venture Capital Association, October 2015, pp 8.

circumstances. However, the market risk can only be mitigated but not entirely removed.

Capital risk concerns the chance an investor has of losing money because of the failure of an investment. Capital risk is affected by both external and internal factors. In the former case, it is about the failure of an investment due to unpredictable events (e.g., investing in the travel sector just before a pandemic); in the latter case, it regards the bad selection of companies or the pessimal financial strategy operated.

Financial leverage risk can be associated to the amount of debt that a fund (or a company) employs to finance its investments. Whenever the fund's returns are greater than the financial debt cumulated to purchase assets, the financial leverage may increase the yield on the investment. On the contrary, in case of a profitability contraction (i.e., returns lower than the collected debt), the use of financial leverage entails a negative amplification effect on the losses. Furthermore, the usage of the financial leverage has to deal with the fluctuation of the interest rates: higher interest rates imply higher financial charges that, on the whole, weigh on the company's performances.

All of the previous risks, together with information asymmetries, are the major issues associated to investments in private markets. People who would undertake this path should take into account those risks and accurately ponder whether to manage private assets or not.

2.2 Investment Strategies

It is possible to invest in private markets throughout several financial strategies and instruments. The most renowned forms of private capital investments are private equities, private debts and private real assets. Instead, for what concern the ways investments are undertaken, there are two possibilities, whether it is about direct or indirect channel. In most cases, the direct channel is reserved for institutional investors or individuals with a very large patrimony who have the possibility to place financial resources straight into the companies they are interested into. On the other hand, stands the indirect way, which is usually used by non-professional investors that run private capital investment by entering in a partnership with private market funds, subjects specialized in founding and financing high-potential business that are expected to be very profitable in a predictable future perspective. Both ways of investing share the project of financing private companies with the goal of expanding early-stage businesses to let them reach their pure maturity or even an initial public offering. However, the main difference consists of the way those companies are approached. Individual investors usually lack the expertise and the experience to run such complicated strategies properly. Furthermore, non-listed companies are not keen on providing detailed reports about their affairs. Hence, due to the great difficulty of getting information, individual investors are probably going to have much more troubles with respect to

institutional investors, which have the possibility to employ much more resources to investigate and gathering data. For all of those reasons, individual investors prefer to lean on financial intermediaries, experts that facilitate their investments into private markets.

2.2.1 Private equity

"*The term 'private equity' has no consistently applied definition and refers, in general, to any investment towards companies that are not listed or quoted on a recognized financial market*"[30]. There are several forms of private capital investments, even though private equity represents the most common one. That specific type of investment is usually pursued by private equity funds that confer financial resources toward non-public companies that desire to experience the transaction from early stages to maturity.

Private equity strategies are very wide and differentiated, however the main ones can be divided in three groups: venture capital, leveraged buyout and growth capital. It is about venture capital when investors finance businesses in their first stages of life. Then, growth capital targets realities that still have reach their full maturity, therefore the need of investors who are able to finance projects that will demonstrate and release the company's true potential. Those two types of strategies

[30] John Gilligan and Mike Wright, "Private Equity Demystified – An Explanatory Guide", second edition, 2010, pp.16

involve acquiring the minority stake of a company. Instead, leveraged buyouts interest the majority acquisition or the incorporation of well-structured businesses with solid financial returns.

Venture capital (hereinafter also referred to as VC) regards investments made in start-up companies in order to finance the launch of new businesses. VC are medium-long term investments that target the minority stake of a company, giving it the financial resources to begin the activities.

Venture capital can be divided in three main phases: seed capital, start-up capital and expansion capital. According to Grabenwater and Weidig, "*seed capital finances the research, asses and development of a product; start-up capital finances the set-up of a company, the further development and the initial marketing of the product; finally, expansion capital finances further growth, for example increasing the productivity or providing working capital, once the whole business reaches its break-even point*[31].

The companies selected by private equity funds usually belong to sectors that are considered to be able to experience a strong and rapid growth. Examples could be the sectors of high-tech, biotech or healthcare, which are facing an extraordinary increase during the last years, both in terms of novelties (e.g., patent application, inventions) and capital investments. Obviously, higher margins of

[31] Cf. Grabenwater and Weidig, "Exposed to the J-curve: Understanding and managing private equity fund and investments", 2005.

growth imply higher risks. This is the reason why, in some cases, companies operating in such sectors face difficulties in receiving funds from banks. As explained in the first chapter, banks are much more conservative with respect to private equity funds that look at private capitals as an appealing opportunity for providing investors tempting financial returns, as well as differentiating the gamma of strategies and investments.

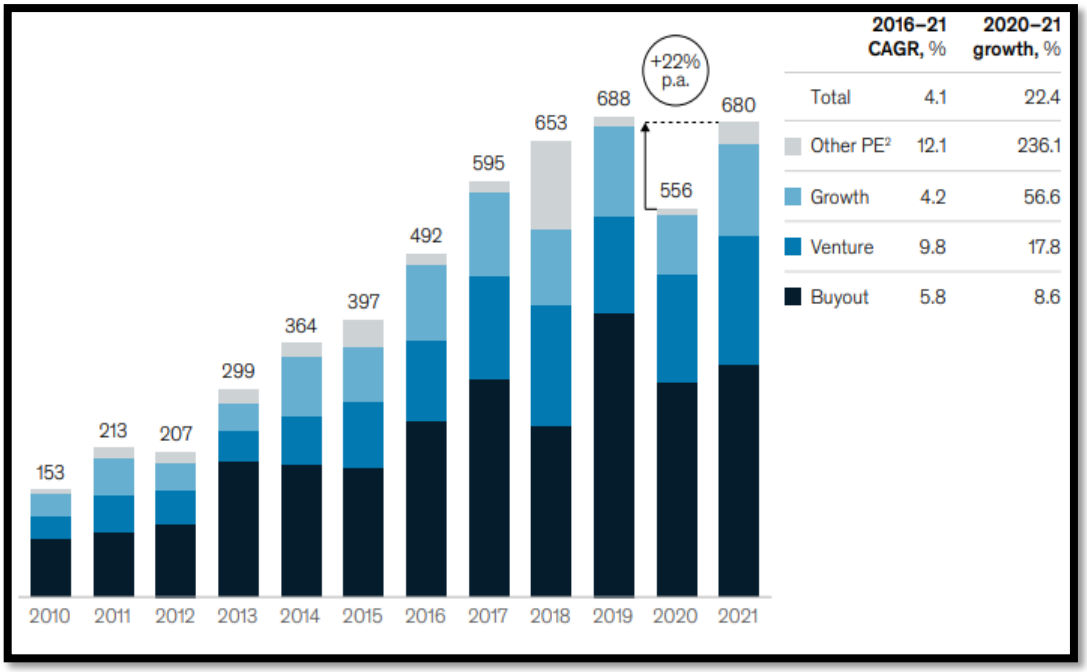
Growth capital (hereinafter also referred to as GC) is a further private equity strategy which involves expansion projects such as internationalization, restructuring or the start of new activities. Growth capital deals with minority stake investments that do not involve a transfer in a company's ownership. Moreover, GC targets relatively mature companies that need financial resources to expand their business: usually growth capital funds work with those realities that see their debt request denied by banks. Although CG shares some traits with VC, the former one differs a lot with the latter one both in the length of the investment and in risk-return profile. While venture capital is a strategy that needs, on average, from 5 to 10 years to reveal itself profitable, growth capital only needs, on average, from 3 to 5 years, given that the target companies are relatively mature and don't have to set up the whole business. That statements entail a VC level of risk much higher than the one of GC and a VC return expectation much more volatile, with many booms and busts, with respect to the more stable return expectation of GC.

Leveraged buyouts (hereinafter also referred to as LBO) represents a different category of private equity strategy since it concerns getting the majority stake of well-established, well-structured companies that generate a stable and a predictable cash flow. The LBO strategy implies acquiring a company by using just a small portion of equity and a wide portion of debt. According to Steven N. Kaplan and Per Stromberg, "*The buyout is typically financed with 60 to 90 percent debt—hence the term, leveraged buyout. The debt almost always includes a loan portion that is senior and secured and is arranged by a bank or an investment bank*"[32]. Indeed, the buying entity (usually a private equity fund) finances the acquisition of a target company by both employing its own resources and by using borrowed money that are backed by the target company's assets. In a nutshell, an LBO leverages the acquisition company's assets to get debt finance to buy the company, instead of buying it by only purchasing its equities. If the investment goes well the leverage enhances the financial return, so that the higher the debt employed the higher the yield. Symmetrically, wrong investments with a high debt and leverage intensify the losses. Most of the transactions in the private equity market are related to LBOs, that's why the term leveraged buyout is commonly associated (even

[32] Steven N. Kaplan and Per Stromberg, "Leveraged Buyouts and Private Equity", Journal of Economic Perspectives, Volume 23, Number 1, Winter 2009, ppg 121 – 146.

wrongly) to private equity firms. The high potential of this operation derives from the acquisition of robust businesses[33].

Figure 12: Global private equity fundraising by asset class[1] ($ billion, 2010 – 2021)



[1] *Excluding secondaries, funds of funds, and co-investments vehicles to avoid double counting of fundraised capital*

[2] *Including turnaround PE funds and PE funds with unspecified strategy.*

Source: McKinsey Global Private Markets Review 2022, "Private markets rally to new heights"

The previous chart, *Figure 12*, expresses the extent to which private equity's fundraising is divided among different subclasses: the principals private equity

[33] Cf. Kay Muller, "Investing in private equity partnership: the role of monitoring and reporting", first edition, 2008.

strategies are the one just discussed, thus leveraged buyout, venture capital and growth capital. Just a small part of the graph is linked to other strategies such as rescue capital or replacement capital. From *figure 12,* it is appreciable that LBO is most implemented strategy with an increasing trend over the time period under discussion. Although the pandemic slowed down leveraged buyout's growth the last five years registered a positive 5.8% in the global fundraising. For its part, VC is experiencing a very strong increase: the 9.8% CAGR during the last quinquennium reveals the tendency investors have to seek for more remunerative investments, despite the higher level of risk. For what concern GC, it is enhancing its global fundraising by a fair 4.2 in the abovementioned period. Growth capital remains a good strategy to implement when looking for an asset which is decorrelated from public market and has a modest degree of risk. Finally, other private equity strategies show a shocking 12.1% CAGR in the last five years. However, it is a relative number that should also be seen on its absolute side: the mentioned 12.1% is the result of a generally low global fundraising and the explosion occurred in 2018. Nevertheless, those other private equity strategies are coming out to meet the investors' demand for new and more differentiated offers.

2.2.2 Private debt

Private debt is about providing financial support through loans in place of traditional lenders. For instance, due to their conservative approach, banks do not

undertake the risk of giving money to uncertain activities or companies in trouble. Therefore, when firms' requests for lending are denied by those institutions, they come to private debt funds who are interested in investing in business with high potential returns. Distressed debt, mezzanine financing and direct lending are three main strategies used by private debt funds to invest in companies.

Distressed debt funds operate by buying the debt of suffering business to receive a discount on the acquisition. At this point, the fund decides whether to pursue a trading opportunity or a holding behavior (also called loan-to-own). The first tactics is employed by those funds who have predicted the happening of future events that will create the conditions for a quick sale, monetizing on the difference between the discounted acquisition price and the resell price. The weak point is the necessity of a consistent liquid market able to satisfy the offer side. Instead, the other tactics is about acquiring the debt of a company to heal and restructure it. Usually, distressed debt funds convert their debt into equities to take control of the company's management; then, they liquidate former investors and start upgrading the business activities. Finally, once the company has turned back profitable the fund sells it. This second strategy is implemented by the majority of distressed debt funds given the scarce liquidity offered by private markets. One more important aspect to consider is the risk of buying debt of companies in trouble. For this reason, distressed debt funds tend to target firms that possess assets that can be easily liquidated in the case restructuring fails. Hence, fund managers evaluate target

companies in a way that the price they are willing to pay to acquire the debt will be inferior or equal to the value of all the assets re-sellable on a secondary market. Therefore, they compute the liquidation value of the firm before setting the price of the acquisition plan in order to lower the risks connected to borrowing money. Distressed debt funds cover about 32% of private debt investments and roughly 6% of the total private market universe. To stress the importance of this financial strategy it is interesting to cite Demaria, who stated that "*110 US DD funds created between 1990 and 2008 collectively representing $94.2 billion generated a pooled average net IRR of 11.7 percent. Their pooled average MOIC is 1.56×. This has to be compared with a Public Market Equivalent (PME) of 1.36×. The average time to liquidity is four years*"[34].

Mezzanine financing is a hybrid investment strategy that places between private equity and pure loan financing. The mezzanine debt contract involves providing subordinated loans in exchange of interests on profits (similar to equity), interests on loans and, in most of the cases, the possibility to swap debts into equities. The borrower usually pledges his business as guarantee for the loan to incentivize lenders' investments and giving them a way to ensure their financial claims in case of default. The interest rates paid are considerably high because

[34] Demaria C., Pedergnana M., He R., Rissi R., Debrand S., "Asset allocation and private markets: a guide to investing with private equity, private debt and private real assets", First edition, 2021, pp 130.

mezzanine debt usually has a lower pay off priority than senior debts, so that the mezzaner (lender) will be the last one on the line to receive his money back in the event of a business failure. Mezzanine financing is flexible investment strategy since both parts directly negotiate the terms like loan's duration, interest rate, debt into equity conversion right or other classical contract elements such as constrains and obligations. On the whole, mezzanine debt funds blend the protection given by high debt securities and equity conversion gains to counterbalance the negative presence of subordinated loans. Despite the higher risks concerning this investment, mezzanine financing concerns about 11% of private debt investments and roughly 2% of the total private market universe. According to Demaria, "*82 US mezzanine funds created from 1986 to 2008 collectively representing $30.8 billion generated a pooled average net IRR of 9 percent. The pooled average MOIC is 1.42×. This has to be compared to a Public Market Equivalent (PME) of 1.38×. The average time to liquidity is 4.1 years*"[35].

Direct lending is an activity that consist of providing loans to finance (usually) one-off operations of small and mid-sized businesses. It is very similar to the service of senior lending provided by banks; the difference stands in the fact that the purpose of private market funds is very peculiar and most of the time is

[35] Demaria C., Pedergnana M., He R., Rissi R., Debrand S., "Asset allocation and private markets: a guide to investing with private equity, private debt and private real assets", First edition, 2021, pp 132.

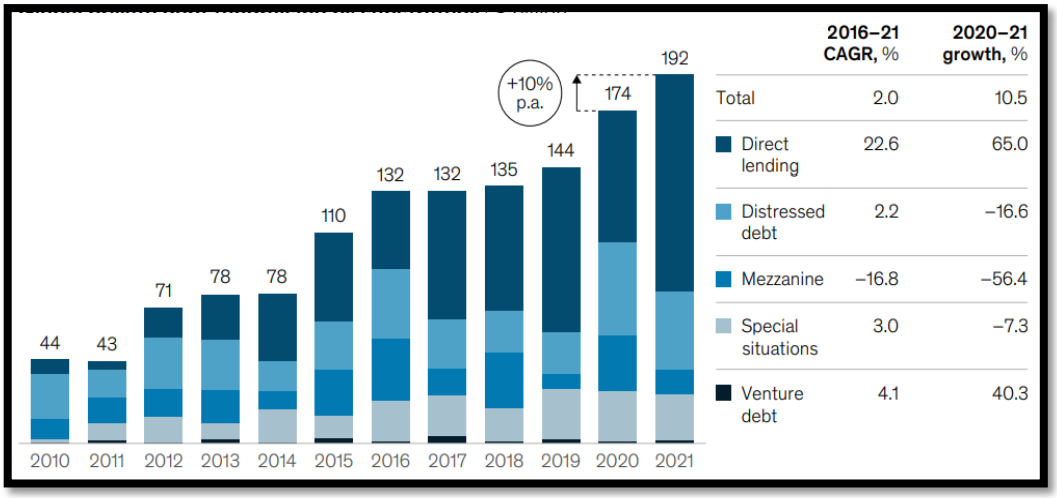
difficult to measure the expected return. Indeed, banks provide senior lending to business that aim to expand an already consistent business; this gives the possibility to compute statistics that determine the risk of a failure and of a success. On the basis of this study the banks decides whether to give the loan or not. On the contrary, direct lending from private funds find it difficult to evaluate specific operations like launching a subsidiary abroad or incorporating another company. Obviously, the risk private funds undertake are higher than the one of banks. In this regard, the analysis fund managers do go beyond documentation such as balance sheets and sector studies; it implies a close relation with the company, directly looking the operations, being on the ground and touching with hand the business in order to understand the real robustness of the firm that is the best indicator of the feasibility of an investment. According to Demaria, "*not surprisingly, direct lending fund managers operate essentially in countries with stable and low inflation rates, with strong and predictable legal environments, and where courts can rule relatively fast and judgments can be enforced without major hurdles. Developed markets, namely the US but also more recently Western Europe, are the main locations of this type of activity*"[36].

[36] Demaria C., Pedergnana M., He R., Rissi R., Debrand S., "Asset allocation and private markets: a guide to investing with private equity, private debt and private real assets", First edition, 2021, pp 134.

The financial return of direct lending comes from the payment of interests over the loan provided. Risks associated to this kind of investment are mitigated by the apposition of restrictions and covenants within the loan contract. Moreover, claims on assets may be included in some circumstances like the market crisis or the borrower financial trouble in order to reinforce the level of assurance. Fund managers use these methods to preserve the fund from companies' failures and from market slump that end up with losing a relevant amount of money. Finally, it should be considered the floating-rate nature of this private debt instrument: since most of the profit of direct lending comes from the interests paid over the loan delivered, this instrument grants a relative protection against inflation and the fluctuation of interest rates. This investment could be view as an alternative to high-yield bonds and leveraged loans, given the fact that it targets small and mid-size businesses, thus a very large number of companies. Given these assumptions, it is not a case that direct lending is the most common instrument in private debt investments. The following chart, *figure 13*, is the proof of the previous statements. It is interesting to note that the global private debt fundraising didn't slow down during 2020, as the majority of financial instruments did. In fact, according to McKinsey and Company, it was registered an increase of 10% during the last year. In detail, in the last quinquennium, direct lending had a compound annual growth rate of 22.6%; in the meanwhile, distressed debt, special situation and venture debt recorded a little

positive sign of respectively 2.2%, 3.0%, 4.1%.; the sore point regards mezzanine financing which went down of about 17 percentage points.

Figure 13: Global private debt fundraising by strategy[1] ($ billion, 2010 – 2021)



[1] *Excludes secondaries, funds of funds, and co-investment vehicles to avoid double counting of fundraised capital.*

Source: McKinsey Global Private Markets Review 2022, "Private markets rally to new heights"

On the whole, it is notable that the most significant changes occurred in direct lending and mezzanine financing probably due to the fact that they have characteristics in common, so that funds managers had to decide whether to opt for one or another.

2.2.3 Private real assets

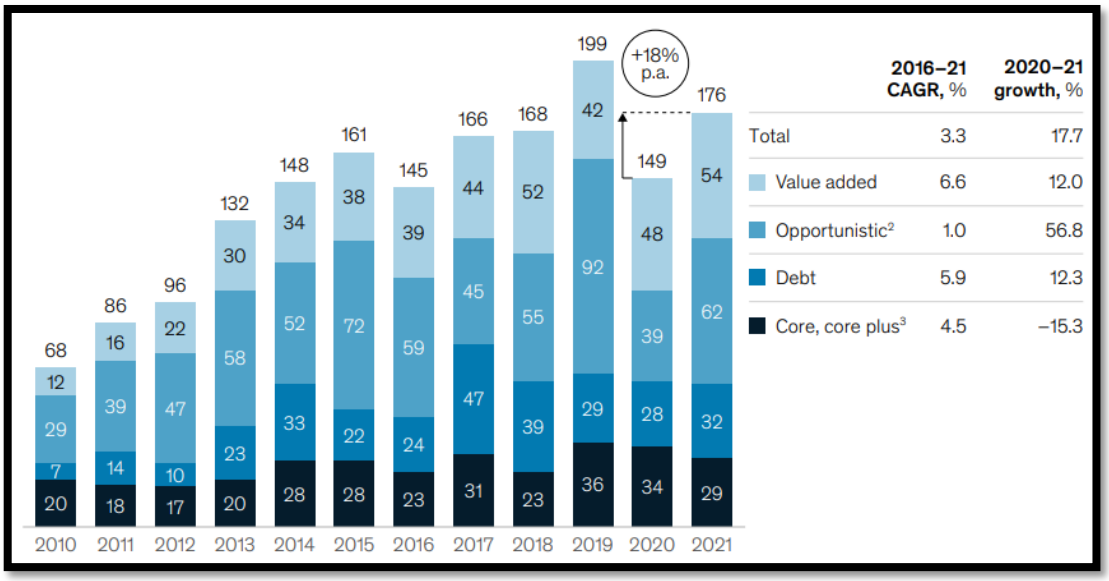
Private real asset regards generating capital gains and income surpluses through the acquisition, the management, the transformation and the sale of real and tangible assets over time. This financial instrument differs from private equity and private debt because of the division between the tangible part and the intangible one. For instance, when a private equity fund buys equities of a company it acquires multiple factors: material instruments useful for the production, the labor of the employees, the techniques of production, the relation with wholesalers and customers, the management of the company and so on. On the contrary, private real asset funds buys only the materialistic aspect within the investment (it may be a building, an infrastructure or even a land), expecting to generate profit by managing or transforming it. Investments in private real asset can be divided in real estate and infrastructure and natural resources (considering both renewable and non-renewable).

The idea behind private real estate is that of buying buildings like residential units, offices, warehouses, plants and whatsoever in order to enhance their value and take profit from their future sale. Private real estate funds increase the price of their assets by handling and bettering them. Depending on the level of risk and on the process, there can be distinguished core, value added and opportunistic real estate investments. The first ones represent very consistent assets: it is the case of building in prime location that do not necessitate of a structural transformation. This

is a buy to hold business: profit comes from the general raise of the price of the buildings in a city due to the prestige and the expansion of the city itself. Therefore, the involvement of fund managers is very low. At second, value added investments require a more active participation by the fund management because there is need to intervene. The assets under discussion are lands or buildings located in secondary spots that demand for restructuring. In this case the transformation process covers an important role since the selling price of a building or a land varies a lot basing on how appealing they are through a work of upgrading. Finally, opportunistic investments include low-interest and neglected zones or buildings that have a poor market, both in demand and offer. There is no doubt this the riskiest investment, however it may be undertaken by those visionary fund managers who gamble on a profound changing occurring in a particular area. Here the level of involvement is the highest, given that it is necessary to analyze the opportunities that can derive from it by inch. That's why it is called opportunistic. For example, imagine a real estate fund to buy a poor land outside a mid-size city which is suitable for edifying. Day after day the city expands. One day the city needs an airport and the best ground to establish it is that poor land that the fund bought some year before. This is the situation of a deep re-evaluation of an area. A disused land registered an extraordinary financial surplus and an opportunistic investment turned to be very profitable. Obviously, the chance something like that happen are very low but the example clearly shows the point.

Private real estate funds regard about 36% of the category of private real asset and, on the whole, around 10% of the private market transactions. According to McKinsey & Company, "*the median net IRR to date for real estate funds stands at 10.7 percent, higher than all other private asset classes except PE*"[37]. The next chart, *figure 14,* is the representation of these data.

Figure 14: Global private real estate fundraising divided by categories[1] ($ billion)



[1] *Secondaries and funds of funds are excluded to avoid double counting of fundraised capital.*

[2] *Includes real estate distressed.*

[3] *Includes real estate core, core plus.*

Source: McKinsey Global Private Markets Review 2022, "Private markets rally to new heights"

[37] McKinsey Global Private Markets Review 2022, "Private markets rally to new heights"

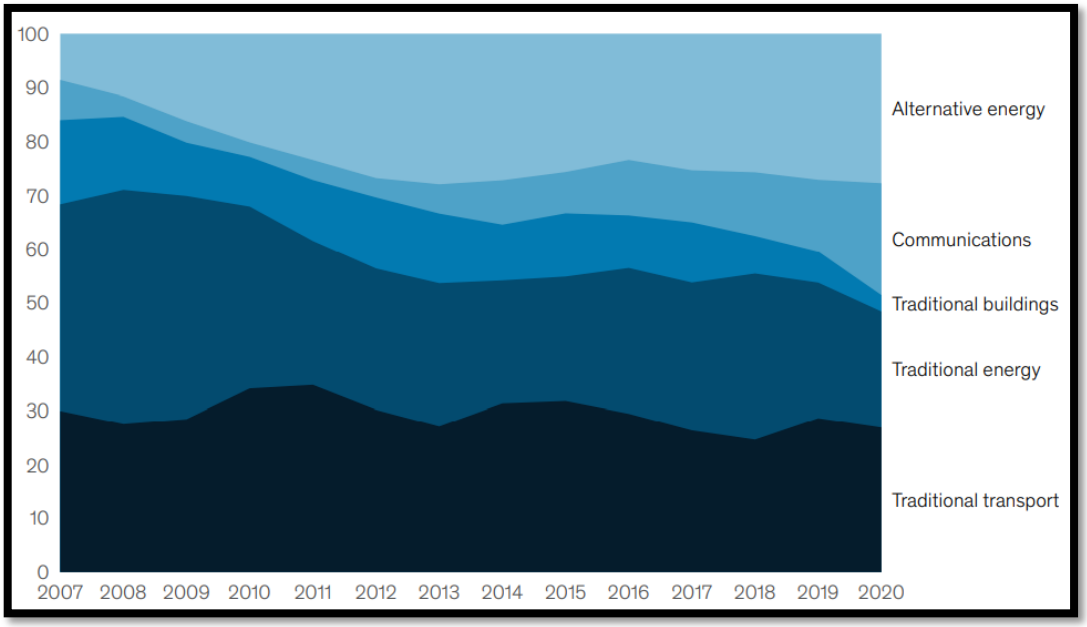
The fact is that private real estate is a performing asset that benefit from being an attractive alternative to the other financial instruments. It is visible how the increasing trend of the last decade has just been slowed down by thew impact of the pandemic. Nevertheless, especially in historical period characterized by a high level of uncertainty, real estate (as well as gold) turns back to be the solution to the fluctuating financial market because of its nature of safe-haven asset.

Going deeper into the analysis, it can be pointed out that core investments cover just a small part of the total fundraised capital since its low risk is counterbalanced by its low financial return. Once again, this fact stresses the concept of private market investments: purchasing medium or high risk and illiquid assets able to differentiate the portfolio and provide great profit is the common driver of private funds' investors. Indeed, value added and opportunistic investments are preferred to the abovementioned core because of the tempting opportunities they can generate.

Infrastructure and natural resources are the new frontier of investment both nowadays and in a foreseeable future. World resources are becoming scarcer day after day and there is need to invest in something able to transform garbage in resources, to limit wastes and to enhance welfare worldwide in order to preserve this sick world. The ESG investment campaign is modifying investors' portfolio, preferring over those companies which pollute to create those companies which create from pollution.

Private real asset funds' investments are the demonstration that this changing is happening. On the one hand, there are private funds which support the progress and development of infrastructure regarding transportation, utilities and communication; on the other hand, there are those funds which finance natural resources business working to produce energy and more resources.

Figure 15: Sector share of global infrastructure deal value (2007-2020)

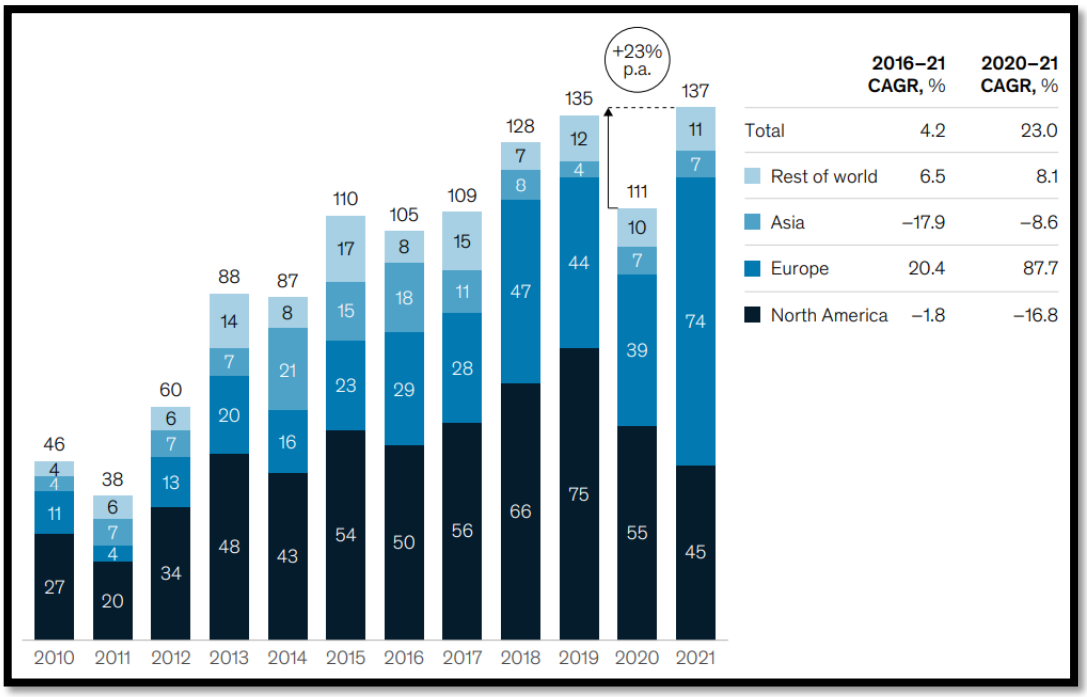


Source: McKinsey Global Private Markets Review 2022, "Private markets rally to new heights"

A distinction should be made between investments in non-renewable energy such as oil and gas and renewable energy coming from solar panels, wind turbines, biomass plants or hydroelectric farms: the latter category is much more considered

because of the pollution created and the low availability of the former. Therefore, the entire financial market is driving into the direction of abandoning the oil and gas in favor of the sustainable and renewable energies. In this respect, the previous chart, *figure 15*, gives an overview of the mutation occurred starting from 2007. Although traditional transportation category remained almost stable over the last fifteen years, the traditional energy and the traditional buildings sectors have experienced a decline. On the opposite stand the sectors of alternative energy and communication, which enlarged a lot their deal values. This graph is an important element to evidence the imponent evolution the world economy has had and still has. Moreover, the following *figure 16* is another witness of how much private market funds are stressing investments toward infrastructure and natural resource. In a twelve years timespan, these previous assets have observed their global fundraising going from $ 46 billion (2010) to the all-time peak of $ 137 billion (2021). The pandemic affected a lot such kind of investment, even though a very quick recover (with a 2020/2021 CAGR of 23%) lead to highest height ever. Moreover, a deeper analysis brings to light how much effort Europe is dedicating in this direction. In the last five year, Europe strongly financed the investment toward infrastructure and renewable resources: in this period, data show a CAGR 20%. Instead, it is visible a countertendency for what concern North America and Asia, respectively with a CAGR of -1.8% and -17.9%. The rest of the world is doing its part registering a positive 6.5% CAGR.

Figure 16:: Global infrastructure and natural resources private market fundraising by world region1 ($ billion, 2010 - 2021)



[1]*Excludes secondaries, funds of funds, and co-investment vehicles to avoid double counting of fundraised capital.*

Source: McKinsey Global Private Markets Review 2022, "Private markets rally to new heights"

All in all, private equity, private debt and private real assets account for about 1.2 trillion dollars, which is an impressive capital fundraising. The increasing trend of all the discussed investment strategies is an indicator of the fact that investors are confident about private markets on their globality and that private assets could be an alternative response to some traditional non-performing assets.

Chapter 3 – Case study: the Azimut group

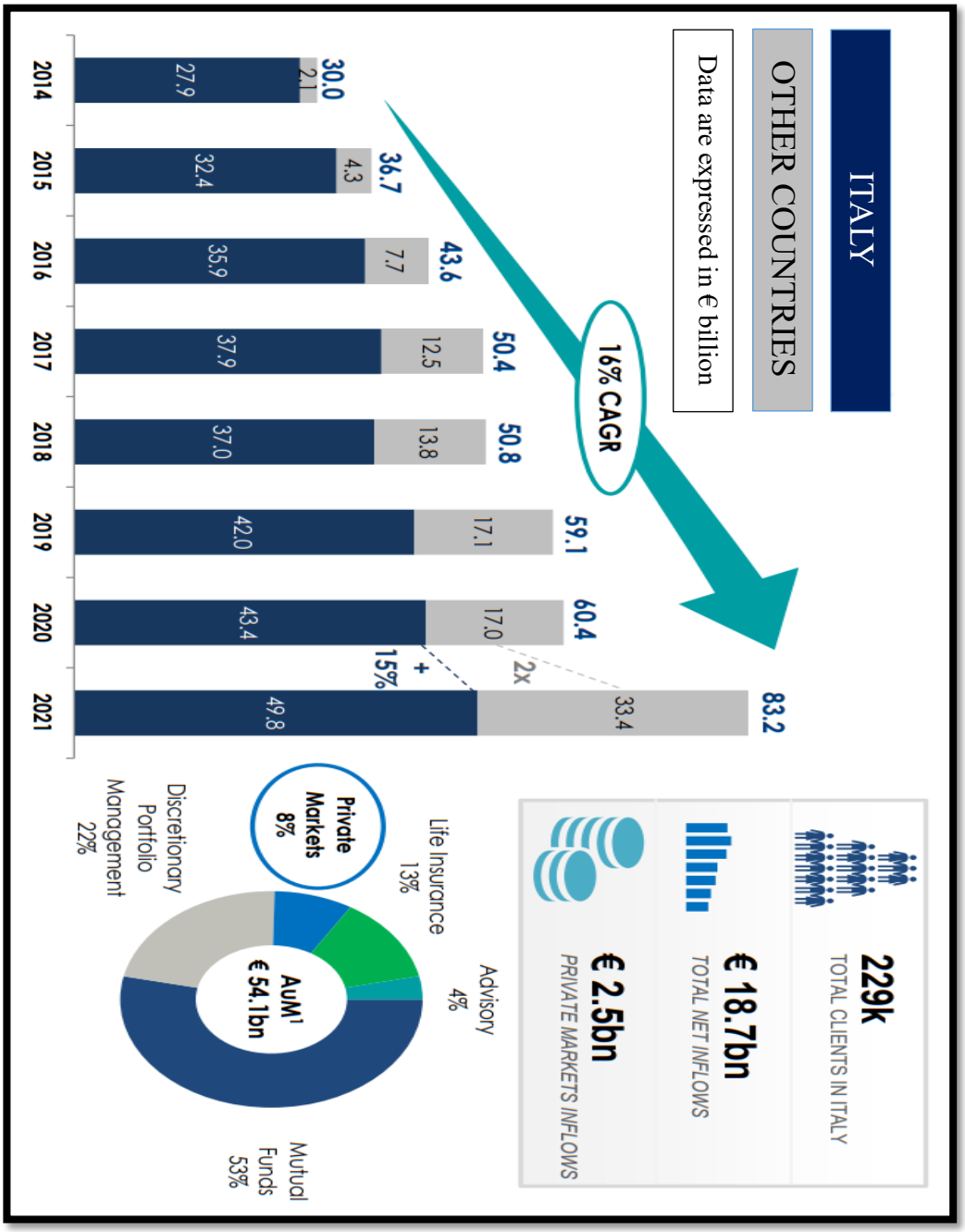
This last chapter focuses on the analysis of the Azimut group (hereinafter also referred to as "Azimut"), which is an Italian asset management company operating as financial intermediary in many countries of the world. The Azimut group believes a lot in alternative investments and encourages its investors to take advantage of the differentiated gamma of products offered by the society. Within this variety of solutions there are many pioneering options such as funds of private equity, private debt, private real asset and also ESG funds. Each one of them is designed to encounter the investors' demand for alternative products and to sustain the structure of the Italian economy by providing alternative financing to Italian small-medium enterprises that are the core target of Azimut's private investments. Therefore, this chapter aims to report empirical evidence of the investments in private market that this company is carrying on. That was possible thanks to the analysis of the fund "Azimut Demos 1", specifically through the study of the management report as of December 31, 2021, and other documents personally furnished by the company. Moreover, this chapter stresses the importance of financial intermediaries using the Azimut group as an example to demonstrate how a financial guide is fundamental to address investors towards a very intriguing but complicated world such as private capital investment.

3.1 Features and purpose

The Azimut group is an Italian society operating in the field of asset management since 1989, the year of its foundation. It is based in Milan and, since 2004, it is traded on the Italian Stock Exchange, known as FTSE MIB index. To the present day, Azimut is the main independent Italian group working in the business of assets under management (hereinafter also referred to as AuM) and it counts a patrimony of € 83.2 billion administrated capitals. A peculiar business philosophy has always characterized the Azimut working method. Independence, partnership, simplicity, stability, velocity and growth are the fundamental cornerstones that uphold this company. Through this scale of values, it was possible for Azimut to gather many clients all over the world, that's why, nowadays, it carries on affairs in 18 different countries: Italy, Luxemburg, Ireland, Monaco, China – Hong Kong and China – Shanghai, Switzerland, Singapore, Brazil, Mexico, Taiwan, Chile, U.S.A., Australia, Egypt, Turkey and Arab Emirate.

Azimut entertains business relations with both individuals and institutional investors, giving specific and customized consultancies to each of them. Moreover, this society operates into the ground analyzing directly the more interesting companies. For this reason, Azimut can be viewed as the meeting point between investors and enterprises. The following chart, *figure 17*, depicts an overview of Azimut's statistics and main activities.

Figure 17: Azimut total asset breakdown (€ billion)



[1] *Figures referred to Managed Assets net of double counting*

Source: Azimut Group "IR presentation", June 2022

From *figure 17*, it is appreciable the strong increasing trend of Azimut's managed capitals: in 2014 there were €30 billion of AuM while in 2021 it was registered a totality of €83.2 billion. This means a CAGR of 16%, which is an incredible result considering the eight-years-long timespan under discussion. Moreover, it stands out the great jump from the €60.4 billion of 2020 to the aforementioned €83.2 billion of 2021. In particular, the difference was made by foreign capitals: this statistic doubled from €17 billion to €34.4 billion in 2021. Instead, Italian capitals maintained a fair increasing trend during all the debated years. On the other half of the chart, data provide statistics about the quantity of Azimut's Italian clients (229k), the net revenue from foreign investments (€18.7 billion) and the inflow generated by private markets (€2.5 billion), being this latter a fast-growing sector. Last, the circular chart highlights Azimut's assets allocation: mutual funds are the most important activity involving more than a half of Azimut's business, precisely the 53%; discretionary portfolio management is the second most conducted activity covering the 22%; life insurance places third with the 13%; in the last two positions there private markets and advisory involving respectively the 8% and the 4% of the assets. Globally speaking, Azimut is experiencing a significant growth, both in terms of clients and AuM. Then, although its main focus on Italian market, it should be emphasized Azimut's great progress in internationalization. All in all, Azimut offers a wide gamma of products in several investments sector that allow investors to choose the most suitable investments for themselves.

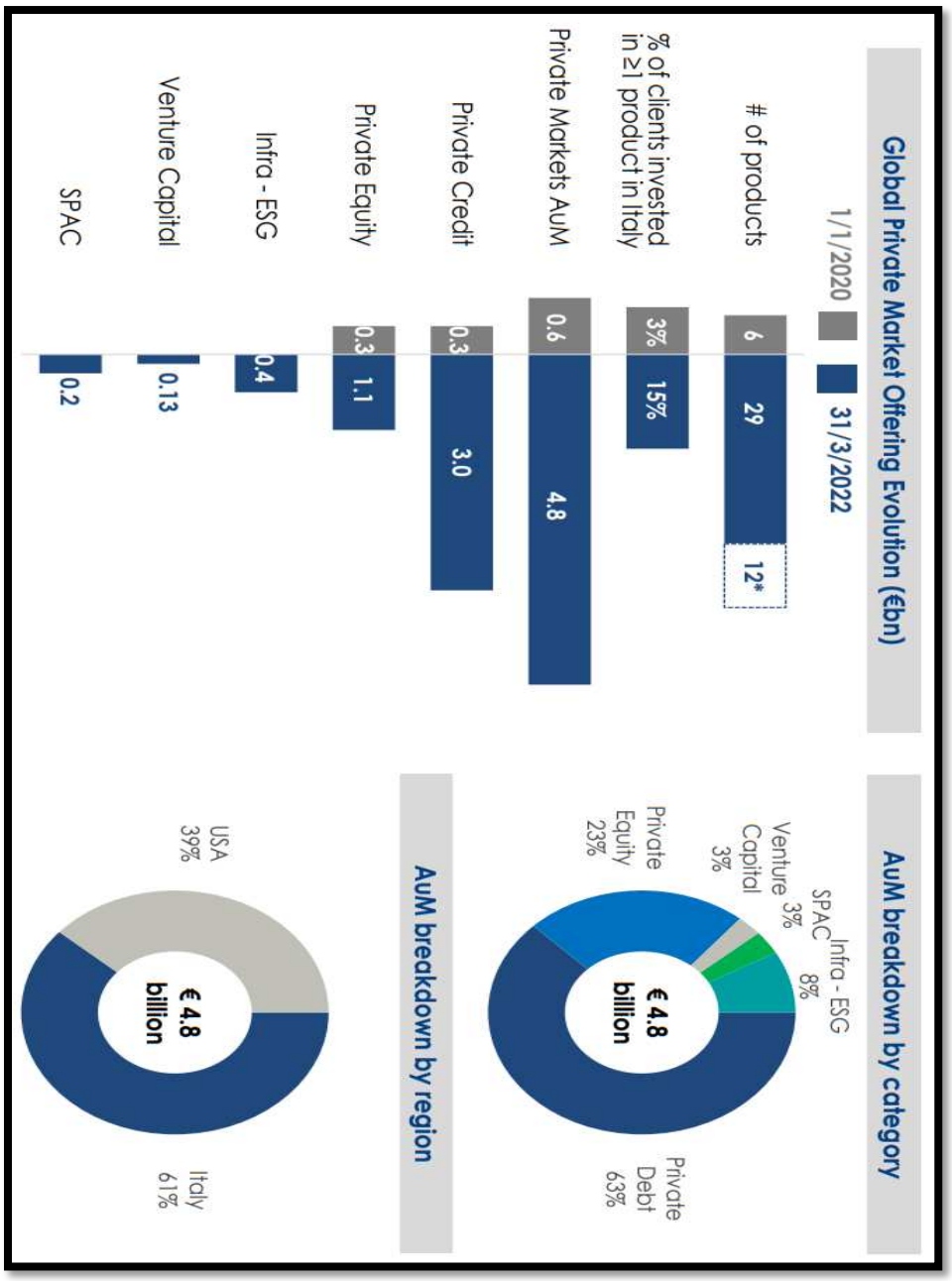
3.2 Azimut towards alternative investments

The Azimut group was one of the first Italian asset management company to invest in private markets. The Azimut's management was able to understand that something changed both in investors' and in entrepreneurs' perspective. Indeed, it was realized that, on the one hand, investors were looking for a different investment offer and, on the other hand, entrepreneurs were looking for alternative financing. Azimut "simply" made in touch investors and entrepreneurs by creating financial products able to satisfy both parts. Therefore, injecting liquidity into the small medium enterprises market to boost a sustainable growth and offering investors an appealing return opportunity.

Since 2018, Azimut started creating funds of private debt, private equity and private real asset focusing on an ESG politic with the aim of investing in Italian non listed enterprises. At that time, Azimut's 10-year prospect was to implement about twenty private asset products that would result in about 4 billion Euro of assets under management[38]. The Azimut's inclination towards private markets made these previsions true in less than five years. The next prospectus, *figure 18*, is the demonstration of the previous statements.

[38] Cf. Paolo Martini, "L'arte di fare impresa. Come e perché investire in economia reale", Azimut Libera Impresa and Azimut Capital Management, 2019.

Figure 18: Azimut private assets under management evolution



** Products currently in fundraising and products reaching closing phase. Here data are expressed in absolute numbers.*

Source: Azimut Group "IR presentation", June 2022

From *figure 18*, it is unequivocal the rate of progress of Azimut's investments in private markets. From the beginning of 2020 until the end of the first quarter of 2022, the gamma of alternative products offered by the company exponentially increased from 6 to 29 (with other 12 products upcoming). Furthermore, Azimut actually counts more than €4.8 billion of assets under management, a score that has multiplied by eight times since the first measurement. Then, the circular charts on the right expose the allocation percentage by strategy and the asset geographical distribution. About the first chart, it can be said that private debt above all (63%) and then private equity (23%) dominate the private capital allocation; nevertheless, there are some other interesting strategies, such as infrastructure – ESG, that are gaining points. About the second chart, it is visible the asset division between USA and Italy, where the majority of resources are concentrated (61%). All in all, the previous statistics demonstrate that Azimut is working into the right direction.

3.2.1 The claim of retail investor

The term retail investor refers to the individual that performs financial transactions on his own behalf through banks, investment companies or whatever financial intermediary. The perspective of a retail investor differs depending on his financial profile: it may be preserving the wealth, obtaining financial returns to counterbalance the inflation or undertaking riskier investments to enhance his own patrimony. In any of these circumstances, very much is based on the financial

resources available and the reason that push the individual to embarking on investments.

According to the Credit Suisse Global Wealth Report of 2017, "*state pensions in advanced economies are expected to replace just 20% of per capita income by 2060, compared with 35% today. Also, fewer workers are now covered by employer-based pensions than in the past, and defined benefit pensions are declining fast. Cribb et al. (2016) report that only 10% of UK workers in the private sector born in the 1980s have a defined benefit pension plan, compared to 40% of those born in the 1960s at the same age. So it is increasingly important for people to save for retirement on their own account*"[39]. These statements clarify why individuals are seeking for alternative perspectives of financial returns. Hence, the explanation of why retail investors are going to play a larger and more important role in the investment's world.

Azimut understood this last point and, indeed, it is driving individuals towards alternative investments in private markets. Nevertheless, Halilov and Huebschmann argued about some limitations of retail investors entering private market funds. They casted doubt over the investment hurdle, the commitment process and the illiquidity issue of those private assets. Private capitals are usually the prerogative of wealthy individuals with large patrimony of professional

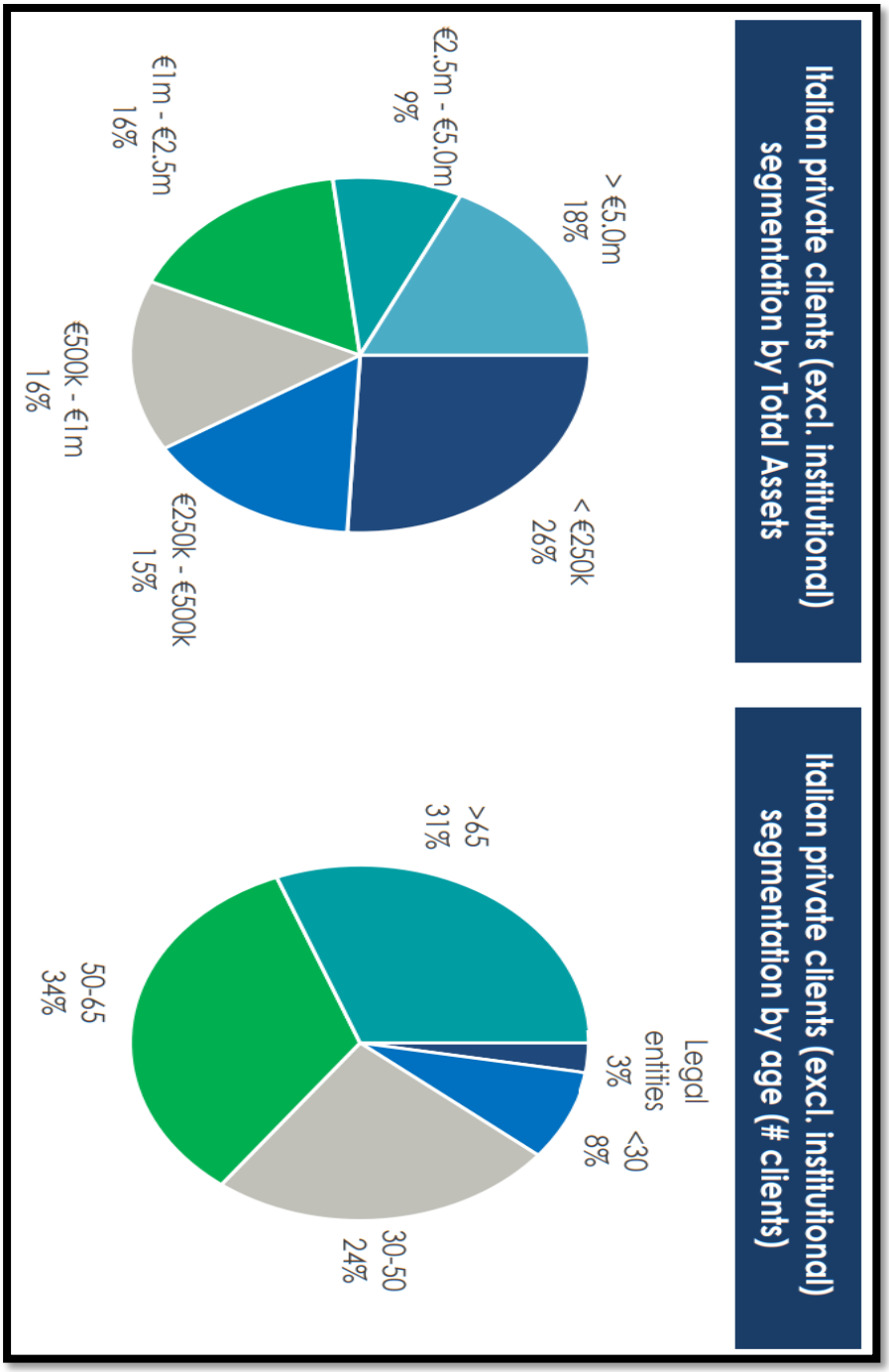
[39] Credit Suisse, "Global Wealth Databook 2017", November 2017.

investors, given the huge amount of the minimum investment hurdle. In this sense, the Azimut group constituted private funds with very low membership thresholds (e.g., Azimut Demos 1 has a minimum subscription of €5,000) with the idea of pooling together the commitments of many individuals in order to break down administrative and management costs. For what concerns the medium-long term illiquidity of private funds, the emergence and the widening of secondary markets will mitigate the liquidity risk and give investors a chance to disinvest if circumstances so require. Putting it on a different perspective, illiquidity can also be viewed as a positive value offered to sterilize the spur-of-the-moment of emotional investors who make bad decisions because of their impulsivity[40].

Given the previous premises, it could be curious to analyze the behavior of Azimut retail investors. The following graph, *figure 19,* illustrates the total assets segmentation (on the left) and the age segmentation (on the right) of private clients. The first chart points out that high variety of investors Azimut has. It is very curious to find out that four out of six segments share almost the same percentage: this means that the number of clients who invest in the maximum range "> €5.0m" is almost equal to those ones who invest in the ranges "€250k – €500k", "€500k – €1m" and "€1m – €2.5m".

[40] Halilov M. and Huebschmann M., "Private Equity Investment Opportunities for Retail Investors", 2019.

Figure 19: Azimut Italian private clients insight



Source: Azimut Group "IR presentation", June 2022

Not surprisingly, the majority of clients belongs to the minimum investment range segment "< 250k", representing more than one quarter of the totality. That witnesses the retail investors' strong demand for entering alternative investments discussed above. About the other chart, it is notable the youngest segment "< 30" participate with just an 8% due to the fact that the youngest category holds much fewer financial resources with respect to the others. The "30 – 50" segment is about one quarter of the total. Instead, the majority of investors comes from the elder segments "50 – 65" and "> 65": these two categories represent approximately two-third of the total. This is extraordinary considering the hazardous reputation of such kind of investments. Globally speaking those two charts show a normal balanced segmentation, when actually they hide a crucial aspect. Although always depicted as risky investments, private capitals reveal themselves to be excellent assets for every age and every budget. The balanced percentages expressed in *figure 19* prove how Azimut is embracing clients from every single market segment and that private capitals invested in the "real economy" are the tangible evidence of a winning concept.

3.1.2 ESG orientation

Referring to ESG orientation means to consider environmental, social and governance factors during the investment-making process. The behavior of a

company can be defined ESG when it takes into account sustainable economic projects of growth.

Given the world's high level of pollution, the overpopulation and the scarcity of resources, it has revealed fundamental to establish a new model of business that would have paid attention to the environmental and the social impact of the economic activities. Furthermore, little by little, investors have become more sensitive to the sustainable aspect: for instance, investing in companies operating in the non-renewable resources' sector is now become counterproductive for the world's existence since the extraction, the refinement and the utilization of sources such as oil entails contaminating and polluting the environment. In this sense, in order to give their contribution to a global improvement, investors are heading their portfolio to investments that can be simultaneously profitable and ESG oriented. The finance too has taken an active participation in this perspective, directing a good share of its funds toward pro-ESG activities. Indeed, Boffo R., and R. Patalano stated that "*Also, building on ESG exclusion, some forms of alternative funds have begun shorting strategies to short what they consider to be unethical issuers, and leverage their investments in higher scoring ESG issuers*"[41].

The Azimut group, for its part, is giving its own contribution in moving towards ESG investments by financing some ESG-focused activities. Indeed, it was

[41] Boffo R., and R. Patalano, "ESG Investing: Practices, Progress and Challenges", OECD Paris, 2020.

created “Azimut Sustainable Future”, which is a fund that is promoting investments that follow ESG criteria defined by the company itself. The first one criterion refers to the implementation of an “exclusion list”: by definition, Azimut excludes all the investments connected to companies that are operating in sectors that are considered detrimental under an environmental and a social point of view. Secondly, the Azimut group targets companies that satisfy the conditions contained in the “Sustainable Finance Disclosure Regulation (SFDR)” that was released in March 2021. Finally, the Azimut group, before completing an acquisition, attributes a rating to the ESG-oriented companies involved in the analysis by taking as benchmark the MSCI ESG Rating scores[42]. In general, Azimut pays great attention to the sustainable part of each company it finances. All of this to communicate to its partners the huge benefits linked to pursuing avant-garde investments in private markets.

3.3 Azimut Demos 1

Azimut Demos 1 is a private equity fund created by Azimut Libera Impresa SGR Spa, which belongs to the group leader Azimut Holding Spa, with the idea of investing in the Italian “real economy”. Azimut talks about real economy when referring to all enterprises and all of their real properties such as lands, buildings, machineries, commodities and, in general, whatever tangible asset concerning the

[42] Cf. Azimut Group, “Azimut Group IR presentation”, June 2022.

production. In particular, Azimut Libera Impresa SGR Spa states that in the modern economic world a sharp distinction separates the real economy from the financial economy. Indeed, the first one is directly linked to the production and the distribution of goods and services, thus all the operational activities of the companies[43].

Throughout Azimut Demos 1, Azimut aims at generating value for the investor by giving financial lifeblood to Italian small and medium enterprises. The final goal of the fund is, indeed, to valorize the assets of the companies under management before selling them at a higher price with respect to the one of the acquisitions. Azimut Demos 1 was structured to execute private equity investments that usually implies the acquisition of target companies' majority stake (in some cases also the minority stake). Those acquisitions have been carried out by using special purpose vehicle (SPV). According to Mark Carey and René M. Stulz, *"an SPV, or a special purpose entity (SPE), is a legal entity that has been set up for a specific, limited purpose by another entity, the sponsoring firm. An SPV can take the form of a corporation, trust, partnership, or a limited liability company. The SPV may be a subsidiary of the sponsoring firm, or it may be an orphan SPV, one that is not consolidated with the sponsoring firm for tax, accounting, or legal*

[43] Cf. Azimut Libera Impresa SGR Spa, internal report.

purposes (or may be consolidated for some purposes but not others)"[44]. Notably, the fund management is focused on researching the best investment opportunities, on handling, monitoring and improving companies' activities and on finding the most rewarding portfolio divestment occasions. For this purpose, the Azimut group has played and still plays an active participation in the management of the acquired companies to ensure that the minimum is leave to fate. In addition, Azimut's management constantly evaluates its investments, paying attention to periodically rectify the value of its assets in order to give a fair value representation to its investors.

3.3.1 Basics of the fund

One important premise should be done before entering the analysis: the report under discussion has been approved by the auditing company PwC, which was in charge of granting the correctness of the data expressed and the accuracy on revealing the right economic and financial position. PwC stated that the management report provides a truthful representation of the facts; that based on the auditing international principles (ISA Italy).

Azimut Libera Impresa SGR Spa instituted the fund Azimut Demos 1 on October 22, 2018. Only at a later time, on August 1, 2019, the fund opened to public

[44] Mark Carey and René M. Stulz, "The Risks of Financial Institutions", University of Chicago Press, 2007.

offering. Azimut Demos 1 is characterized for being the first private equity fund not reserved for institutional investors, also including retail investors. This is a great revolution for what concern private investments: this fund embodies a sort of financial democratization, given that retail investors too are now able to access to new strategies of investment and to contribute to the development of the so-called real economy. According to Azimut statistics, as of 31 December 2021, the 93.5% of the fund has been underwritten by retail investors while the remaining 6.5% is formed by professionals[45].

Azimut Demos 1 offered two types of shares: class "A" and class "B". The first ones had a nominal value of €5,000, they were at disposal of the public and their subscription was unlimited. The only restraint regards the minimum membership subscription amount that was set at €5,000, therefore one share. Instead, the other category had a predetermined number of 2,500 shares with a nominal value of €100; in addition, they had to be subscribed to the extent of 50% by the society and 50% by the management, as agreed in the fund's regulation. That with the aim of correlating the effort of the fund's management with the well-going trend of the fund itself. The first class "A" shares capital call was closed on January 20, 2020, since the subscription requests, more than 162 million Euro, had exceeded the minimum amount required by the fund's regulation to start the investment

[45] Azimut Libera Impresa SGR Spa, "Azimut Demos 1 management report 31/12/2021".

process (100 million Euro). As a consequence of the abundant investors' deposit, on March 20, 2020, the fund officially declared the beginnings of its operations. Subsequently, on the wake of enthusiasm for the optimal result obtained, the society announced a second capital call, collecting over 86 million Euro, before closing the subscriptions on May 31, 2020. Finally, it was proclaimed one last capital call that counted more than 30 million Euro subscribed until the definitive closing date, on July 31, 2020. Taking into account the amount of class "A" shares issued and subscribed, which was more than 279 million Euro, and the amount of class "B" shares, which counted a total of 250,000 Euro, the cumulative commitment gathered by the fund Azimut Demos 1 was 279,270,000 Euro. Since the beginning of the operations on March 20, 2020, the Azimut investment team started to seek for the most profitable and convenient investment deals. Analysts have studied more than 350 potential investment opportunities, even though only 80 of them were selected for an additional analysis. After all, the investment team ended up with a list of seven companies that presented a financial profile in line with the objectives of the fund. As of today, the management completed three out of the seven proposed acquisitions, investing 96.3 million Euro globally. The three acquired companies were Sicer Spa, Pet Care Srl and Induplast Spa. In the meantime, the Azimut investment team still carries on research on other activities with the purpose of discovering new attractive opportunities, always bearing in

mind the current and future impact of the Covid-19 pandemic and the recent conflict in Ukraine.

3.3.2 Operations

3.3.2.1 Sicer Spa

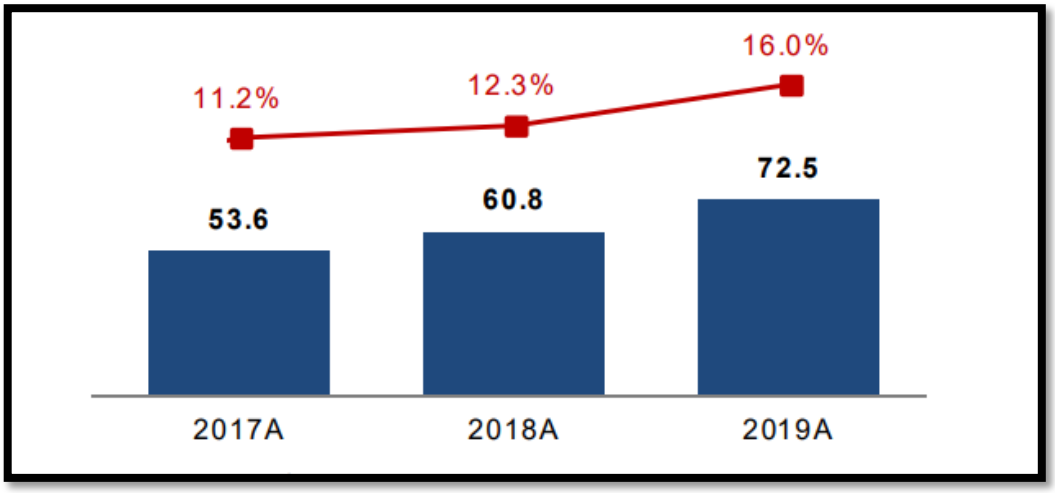
In November 2020, the fund concluded its first venture capital takeover by acquiring the 65% capital stake of the company Sicer Spa. The operation was realized by constituting ALI 1 Dem Srl, a vehicle society created and 100% owned by the Azimut group.

The Sicer Spa is a company which is operating in the field of ceramic treatment for over 25 years. Indeed, it is one of the world leaders in terms of engineering, production and distribution of chemical products useful to garnish ceramic surfaces. During the last years, Sicer Spa has taken a path of growth and decided to expand its business: it has expanded its activities acquiring new customers worldwide, it has developed new chemical avant-garde products for ceramics and it has widened its international profile. Actually, the Sicer Spa possesses manufacturing facilities in Italy, Spain, Mexico, India and Indonesia; in addition, it has commercial subsidiaries in Turkey and Poland[46].

[46] Cf. Marco Capponi, "Azimut investe nell'economia reale, acquista il 65% della modenese Sicer", Milano Finanza, November 11, 2020.

The Azimut group invested in this company because the analysis of the Sicer Spa revealed an important advancement made in terms of clients, internationalization, operational branches and sales volume. That trend is visible in the following graph, *figure 20*, which is the result of the expanding politics put in place by Sicer Spa. The chart depicts the rise of sales volume of the company during the triennium 2017 – 2019. It comes out clear how well this company has performed in that period and why it was selected as an interesting investment opportunity.

Figure 20: revenues (€ million) and EBITDA margin trend of Sicer Spa (2017 – 2019)



Source: Azimut Libera Impresa SGR Spa, internal report

In addition to the previous statistics and according to the company's 2021 balance sheet, the Azimut group pointed out that the revenues of Sicer Spa increased

by 35% with respect to year 2020 and that the EBITDA margin increased by 2% (from 16% to 18%) with respect to year 2020[47].

3.3.2.2 D.M.O. Pet Care Srl – Isola dei Tesori

In December 2020, the fund Azimut Demos 1 took the 27% participation of PI4 Sarl, a vehicle controlled by Peninsula Capital, another investing society interested in the acquisition of the company D.M.O. Pet Care Srl – Isola dei Tesori. That vehicle was in charge of getting the majority participation of the firm, which was the second target of the Azimut's fund. Only at a later time, precisely in January 2021, the vehicle PI4 Sarl acquired the 75% share of the aforesaid company, making the fund Azimut Demos 1 a minority partnership investor.

The D.M.O. Pet Care Srl – Isola dei Tesori is a company operating in the pet care sector. It was founded in 2000 and it got specialized in providing proper food and products for pets' treatment. At the time of acquisition, it was the second Italian sector leader, counting 165 direct operating stores (DOS) and 67 franchising for a cumulative 232 selling points in Italy. During the pandemic isolation the pet care market experienced a boom in the demand of food and more refined accessories[48], thus Azimut decided to target it.

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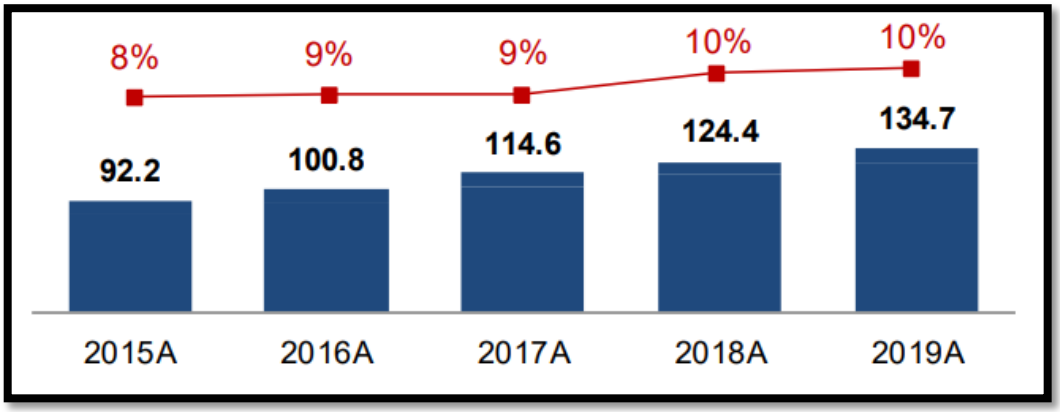
[47] Azimut Libera Impresa SGR Spa, "Azimut Demos 1 management report 31/12/2021".
[48] Cf. Carlo Festa, "I private equity puntano sulla pet economy: Isola dei Tesori a Peninsula e Azimut", Il Sole 24 Ore, December 9, 2020.

Given the study carried out on the company's revenues and EBIDTA margin, the Azimut group decided to target it. Indeed, following graph, *figure 20*, it comes out a positive increasing trend in both statistics. Within the quinquennium under discussion the sales volume of the company massively augmented from €92.2 million to €134.7 million and EBIDTA margins raised from 8% to 10%. This graph witnesses the great status of the company and explains the reason why Azimut wanted to enter the partnership for its acquisition.

Figure 21: revenues (€ million) and EBITDA margin trend of D.M.O. Pet Care Srl (2015 – 2019)



Source: Azimut Libera Impresa SGR Spa, internal report

Also this case presents updated data taken from the company's balance sheet. According to Azimut Libera Impresa SGR Spa, statistics suggest 20% revenues increase as opposed to 2020, reaching an overall turnover of 174 million Euro. Instead, the EBIDTA margin decreased to 11% (12.8 in 2020) reflecting the

impact of the expenditure for new investments implemented by Peninsula and the Azimut group: in particular, that capital expense regards the opening of new stores, the boosting of the e-commerce and the acquisition of another franchise[49].

3.3.2.3 Induplast Srl

In October 2021, the fund Azimut Demos 1 cooperated with another private equity operator, the Armònia SGR Spa, to acquire the 90% of the company Induplast Group Srl, dividing the percentage ownerships equally: 45% for each part. The residual 10% remained on the hands of the founding families and the top management. Also in this case, it was constituted a vehicle 100% owned by the fund, ALI 2 Dem Srl., to perform the acquisition.

The Induplast Group Srl is a well-established reality which operates in the field of packaging within the cosmetics sector. It is considered to be one of the best Italian companies in terms of design, production and distribution of cosmetics container such as sticks, roll-on, tubes or jars. Actually, Induplast counts three societies within the group: Induplast Spa, which is the holding company, Verve Spa and Vexel Srl. The last two subsidiaries have been recently incorporated, more precisely in 2019, because of the desire Induplast had to broaden its business. According to Azimut, preliminary 2021 data highlight a financial return of 42.3 million Euro, which brings out an increasing trend of about 12% with respect to

[49] Azimut Libera Impresa SGR Spa, "Azimut Demos 1 management report 31/12/2021".

2020 (37 million Euro). Nevertheless, the EBITDA margin slightly decrease from 30% to 28% during the same period, probably due to the raise of the cost of raw materials and utilities[50].

3.3.3 Performance perspective

Azimut Demos 1 was structured to be an eight-year long-lasting fund. Specifically, its closing date was established on December 31 of the 8th year following the last capital call for entering the investment. However, Azimut warned that the closing date would vary, undergoing an extension of the term, in case of financial troubles or particular divestment difficulties. Furthermore, the fund's liquidation was determined to take place after the established closing date or the extended one; instead, a premature fund liquidation would happen in case of a dissolution of Azimut Libera Impresa SGR Spa or a justified withdrawal in the fund's management by the company itself.

Before starting the operations, Azimut drew up a prospectus indicating yields and costs for three different scenarios, from the less to the most favorable, assuming a €10,000 investment. Also, the society warned investors about the 6 out of 7 risk indicator (medium-high) and the costs impacts on yields. Referring to costs means to take into account one-time costs, recurring costs and additional charges: the first one category counts for the 1% of the committed capital and it is paid once-

[50] Cf. Azimut Libera Impresa SGR Spa, "Azimut Demos 1 management report 31/12/2021".

only at the subscription; the second category is related to fund management expenses that counts the 2.84% annually; finally, additional charges imply the 20% overperformance commission to the fund management in the case of a hurdle rate greater than 35% at the liquidation stage. Bearing in mind the previous information, it is possible to look at Azimut Demos 1 forecasts, which are expressed in the following chart, *figure 22*. It has been conducted a preliminary analysis that tried to evaluate the expected fund's performances in terms of net return (subtracting costs from total returns) and average yield per year (in percentage).

Figure 22: Azimut Demos 1 performance scenario

	CAPITAL: €10,000	SCENARIO		
		Adverse	Moderate	Favourable
YEAR 1	NET RETURN (€)	8,710.06	10,313,05	12,088,77
	AVERAGE YIELD (%)	-12,9	3,13	20,89
YEAR 4	NET RETURN (€)	8,309.3	11,871,51	18,272,65
	AVERAGE YIELD (%)	-4,52	4,38	16,27
YEAR 8	NET RETURN (€)	8454.69	14,550,11	31,731,48
	AVERAGE YIELD (%)	-2,08	4,8	15,53

Source: Azimut Libera Impresa SGR Spa, internal report

The graph illustrates the performance evolution during the different phases of the fund: investment (early stage), divestment (middle stage) and liquidation (ending stage). Basing on Azimut's forecasts, *figure 22* points out that only one out of three cases, the adverse scenario, ends up with a loss. However, considering bad circumstances and an unfavorable economic conjunction, this investment loses little more than the 2% per year. Undoubtedly, it is not a positive perspective but the relevant fact is that losses are limited: if worst come to worst, a €10,000 capital would diminish of about 15% to the amount of €8454.69. By contrast, the moderate and the favorable scenarios show respectively good and astonishing statistics. In the former case, the committed capital would raise from €10,000 to €14,550.11, evidencing a 4.8% average increase per year (45% on the whole investment); in the latter case, €10,000 would transform into €31,731.48, which would entail triplicating the invested capital (vertiginous growth of more than 200% on the whole). For statistic reasons, the first and the last scenarios are less probable to occur; nevertheless, it is curious to note how those hypotheses differ. In Azimut's opinion, in an adverse situation, losses can be mitigated, while, in an advantageous situation, yields massively increase.

All in all, it can be stated that Azimut Demos 1 is a private equity fund with a medium risk and a high expected return profile that could be very interesting for all of those investors who seek for a riskier but very remunerative asset.

Concluding remarks

Statistics suggest that alternative investments in private markets are, on average, more profitable than traditional investments in public markets. Moreover, private assets offer another extra, which is the differentiation: being medium-high risk-return products, private assets suit perfectly to those investors who have seek for alternative offers.

However, as visible from the charts, private investments are riskier and presuppose a very strong knowledge of the system in order to counter the problems of asymmetric information, transparency and associated risks discussed. It follows that relying on financial intermediaries could be the best solution to reduce the hazard of undertaking unwise investments.

Evidence that investors, both institutional and retail, are approaching private markets is demonstrated by data: the global private market fundraising increased vertiginously from $96 billion to $1,184 billion in less than 20 years; non-regulated non-bank lenders are involved in almost nine out of ten financial deals in the market of small-medium enterprises; finally, the low level of IPO's is the symptom that more and more companies are looking for alternative financing which is provided by private markets.

The case of the Azimut group is the synthesis of all those concepts. Investing in less explored markets, through private assets, is the way to create value for both

investors, in the shape of higher yields, and companies, in the shape of better financing conditions. Moreover, the Azimut group has evolved the notion of private markets investments by democratizing and opening private funds to all the category of investors. The idea of sustaining small-medium enterprises and helping them grow to enhance the profitability of the companies themselves and, consequently, of the investors who have financed them is resulting brilliant by the amount Azimut Demos 1 gathered.

This model of investing presupposes taking more risks, given by private assets illiquidity and decorrelation from public markets. Nonetheless, statistics highlights how the expected yields weigh more than the risks under the investor point of view.

Throughout this dissertation, it was attempted to give proof that alternative investments in private markets could be a valuable option for investors, considering both pros and cons. Statistics witnessed how private assets evolved from being discredited to valid alternative. The Azimut group is the tangible evidence that private markets investments could be beneficial for each actor involved. Therefore, it can be stated that not only private markets refer to performing assets but, also, represent the expansion from a more standardized investment perspective to a pioneering broadened one, where the profit you gain goes hand in hand with the value you create.

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Appendix